

The Lapse Trial: When Being Right May Not Be Enough

Article By:

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Even in the best of circumstances, lapse trials are challenging for a life insurer. Several years ago, as I was preparing for a jury trial involving a death claim on a lapsed life insurance policy, I did a dry run of my opening statement for my wife—a non-lawyer and a perfectly calibrated barometer of Middle America. I explained how the evidence would not only demonstrate that the policy owner failed to pay sufficient premium during the grace period, but that the policy owner’s attempt to blame the error on a customer service representative was nothing but a post-lapse excuse.

When I finished, my wife just looked at me. After a pause, she asked, “Why didn’t they just let him pay late?” She then reminded me of how irritating it is when a credit card company, for example, won’t remove a \$25 fee on a late payment. “Terminating a life insurance policy seems like an awfully harsh penalty for a mistake.” Another pause. “You’re going to lose.”

This was a much-needed reality check. Up to that point, I had *litigated* dozens of lapse cases, but none had ever gone to trial. I thought the key to winning a lapse case was to demonstrate that the insurer did everything correctly—that it precisely followed the statutes, regulations and the policy terms. My wife’s frown told me otherwise.

To be sure, doing everything right is necessary: No jury will strictly apply the terms of the policy against the policy owner if the insurer hasn’t met all of its obligations. But winning a lapse trial requires more. Any juror who lives a busy life and juggles family and work obligations will understand a missed payment, and she will look for reasons to cut the policy owner a break. This predisposition is strong but not insurmountable. The task of the insurer’s lawyer is not just to prove that his client is correct, but to educate the jury about the nature of life insurance, a unique and frequently misunderstood financial product. Below are three themes to consider when preparing for a lapse trial.

Life insurers do *not* prefer lapses

Policy holder lawyers will argue that life insurers not only love it when policies lapse but are even willing to trick their customers to cause a lapse. For those who have only a passing familiarity with life insurance, this may be a persuasive line of attack. After all, it is obvious that the insurer will benefit by collecting a premium and never paying a death benefit.

It is vital for the insurer’s lawyer to recognize that most people do not appreciate that insurance

markets work based on the “law of large numbers,” and that life insurers readily pay almost all claims. Contrary to popular belief, life insurers work hard to *increase* persistency rates and *decrease* lapse rates to ensure a steady stream of premium revenue in order to pay claims. Insurers go to great lengths to prevent lapses (through policy features like no-lapse guarantees, premium notices, grace notices and ACH debiting, for example). More often than not, the record will demonstrate that the policy lapsed in spite of the insurer’s efforts, not because of them.

Most lapses are intentional

Very few rules have no exceptions, and jurors will want to make an exception for the policy owner who made an honest mistake and is willing to pay his premium, albeit late. And it will do no good to argue that if the insurer makes an exception for this policy owner, it will have to make an exception for all policy owners. In a contest between a grieving widow and upholding an abstract principle, the grieving widow usually wins, particularly if the only “downside” is that similarly situated beneficiaries will receive the same treatment.

But there is another way to explain the need for a consistently applied rule. When people no longer wish to retain their insurance, they rarely call the insurer to cancel, as if it were the cable company. Instead, they stop paying their premium and simply allow the policy to lapse. Without a uniform rule, the insurer would soon be overwhelmed by policy owners who *intentionally* allowed their policies to lapse but regret their decision after a change in health. Allowing exceptions will give rise to an almost impossible task of determining whose policies lapsed by mistake. More significantly, it will remove the incentive for diligence in paying premiums and create a moral hazard—the ultimate anathema to insurance markets.

Life insurers are not judges

Finally, the insurer’s attorney must demonstrate that the insurer is not just being rigid or unsympathetic. The jury must understand it is not the insurer’s role to judge whether the policy owner had a good reason or a bad one for failing to pay premium. The insurer has a duty to follow the law and to administer the policy in good faith. If the company makes an error, it should be quick to rectify the error. But the insurer—much like jurors, who swear an oath to determine the facts without fear or favor—cannot choose to deviate from the commands of the policy. Insurers and their employees also have a duty to set aside their sympathy and administer the policy according to its terms.

Lapse trials are challenging, and there are no sure-fire approaches to winning. But recognizing jurors’ inherent and sincere bias in favor of the policy owner—even when the insurer did everything correctly—and then taking every opportunity to educate the jury are essential ingredients for success.

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