CORPORATE-OWNED LIFE INSURANCE: ANOTHER FINANCIAL SCHEME THAT TAKES ADVANTAGE OF EMPLOYEES AND SHAREHOLDERS

by

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I. INTRODUCTION

For many years corporations have been buying life insurance on the lives of their key employees to protect the corporations from economic losses in the event of the deaths of such employees.[i] Insurance companies encouraged the corporate-owned life insurance (COLI) programs by emphasizing their tax advantages.[ii] Corporations began to maximize the tax benefits by taking large loans to pay for policy premiums and then obtaining large income tax deductions for the interest payments.[iii] When the Tax Reform Act of 1986[iv] curtailed these unintended tax benefits by imposing a $50,000 per-insured-employee limit on the amount of indebtedness for which interest was deductible, insurance companies created new kinds of COLI policies.[v] One kind has been called "dead peasant policies"[vi] or "janitors insurance."[vii] These are life insurance policies that corporations purchase for rank-and-file employees naming the corporation as the beneficiary when the employee dies.[viii]

There is widespread use of janitors insurance by corporations and by banks (BOLI)[ix] because it creates significant improvements in their bottom lines.[x] However, the current arrangement takes advantage of uninformed employees and misleads shareholders. Shareholders also pay for hidden executive compensation when corporations buy "split-dollar" life insurance policies for top executives. These arrangements, in which the premiums are split between the corporation and the executive, create millions of dollars of tax-free compensation for the executives without shareholder knowledge.[xi]

Insurance companies have been very successful in marketing these products to corporations and to banks and, now, even to charities (CHOLI)[xii] with the public and Congress initially paying little attention. The intense focus on corporate scandal after the Enron, Tyco, Adelphia, and WorldCom debacles, however, has created interest in these insurance schemes in the business press and among legislators. Reporters for the Wall Street Journal have been writing regularly about these issues since the beginning of 2002.[xiii] The Internal Revenue Service has been disallowing more deductions taken with respect to these schemes, and courts have been upholding the disallowances.[xiv] It is important that remaining loopholes are plugged while the public's attention is on overreaching by corporations. When no one is watching, it is difficult for rank-and-file employees and non-institutional shareholders to know that they are being taken advantage of by large corporations, aided and abetted by large insurance companies.

Employees should not be worth more to their employers, or former employers, dead than alive. Not only should their consent be required for such an arrangement, but the consent has to be meaningful so they fully comprehend the entire scope of their employers' benefits from insuring their lives. Similarly, shareholders must be able to know when the companies' earnings are being increased by COLI rather than from business activities and when the company's payments for life insurance premiums for executives increase executives' pay and benefits beyond what is clearly reported.

This article first explores the issue of insurable interest, that is, why employers may be allowed to insure the lives of employees whose deaths, individually, have no particular effect on the financial well-being of the company. The article then discusses employees' rights, with respect to COLI, and relevant litigation. The fourth section reviews the tax considerations of COLI and relevant litigation. The fifth section describes how corporations profit from COLI and discusses shareholders' rights to know the sources of corporations' income. The sixth section summarizes split-dollar arrangements that hide executive compensation and their future viability in light of recent legislation. The final section concludes that no one should be able to insure the life of another without the consent of the insured; that corporations should not be able to shift the cost of employee benefit programs to the taxpayer through tax-advantaged COLI programs; and that a corporation should be required to indicate clearly to shareholders the total compensation it is granting top management and the profit it enjoys that is directly attributable to COLI programs.

II. INSURABLE INTEREST

In 1921 the Supreme Court of Pennsylvania declared that

> '[a]n insurable interest . . . must . . . reasonably justify a well-grounded expectation of advantage, dependent upon the life insured, so that the purpose of the party effecting the insurance may be to secure that advantage, and not merely to put a wager upon human life.'. . . [T]here [must be] a real concern in the life of the party

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> named, whose death would be the cause of substantial loss to those who are named as beneficiaries. This does not follow the cessation of ordinary service, but arises where the success of the business is dependent on the continued life of the employee.[xv]

This explanation of "insurable interest" indicates why the law will not allow an individual to pay premiums on a life insurance policy for a stranger and then collect as beneficiary when the stranger dies. For example, years ago it was not unusual for people to buy insurance on the lives of famous people they did not know, betting on their early demise.[xvi] The law of "insurable interest" developed to discourage people without a genuine interest in the continued life of another from wagering on that person's death and from creating a circumstance in which they would benefit from that person's death. As the Texas Supreme Court has said, "[T]he public has a controlling concern that no person have an interest that may give rise to a temptation to destroy [the insured's] life."[xvii] The United States Supreme Court has held that life insurance policies purchased by one without an insurable interest in the insured are against public policy because they constitute "a mere wager, by which the party taking the policy is directly interested in the early death of the [in]sured. Such policies have a tendency to create a desire for the event."[xviii]

Thus, it has been clear that an insurable interest is required to purchase a life insurance policy, but it "is not easy to define with precision what will in all cases constitute as insurable interest, so as to take the contract out of the class of wager policies."[xix] Nevertheless, it has been well accepted since the nineteenth century at least, that each person has the right to insure his or her own life naming someone else as beneficiary.[xx] In addition, almost every state has a statute that describes other circumstances when an insurable interest exists for personal insurance. Most of the statutes start by describing two situations when there is an insurable interest: when there is a close blood or legal relationship that engenders "love and affection;" or when there is "a reasonable expectation of pecuniary advantage through the continued life" of the insured person and consequent loss by reason of his or her death.[xxi]

The latter situation contemplated the interests of creditors or sureties who have obvious financial interests in the continued life of the insured. The "love and affection" interest was generally viewed "as more powerful . . . to protect the life of the insured than any other consideration."[xxii]

The statutes also often create a specific corporate insurable interest in the lives of any directors, officers, or employees whose death might cause financial loss to the corporation.[xxiii] The corporation buys insurance on the lives of these "key" employees naming itself as beneficiary to protect it in the event of the death of such an employee who is important to the corporation's success.[xxiv] In the 1980s, in response to vigorous lobbying by insurance companies, many state insurance departments modified their rules to allow businesses to purchase COLI on the lives of rank-and-file employees whose specific deaths will not have any appreciable effect on the success of the business.[xxv] Moreover, in the last decade or so, some state legislatures have amended their insurable interest statutes so that charitable organizations are deemed to have an insurable interest in the life of any individual who consents to the charity's owning or purchasing life insurance on his or her life.[xxvi] As one reporter has commented, "Why hold a bake sale when you can have a dead pool?"[xxvii]

The result of buying insurance on the life of someone in whom one does not have an insurable interest varies by state. In some states the policy is void; the insurance company is not liable on the contract and may have to pay nothing or may just have to repay the premium payments.[xxviii] In others, if one without an insurable interest in the life of the deceased receives the benefits of a life insurance policy, the executor or administrator of the estate of the deceased may sue to recover the benefits from the recipient.[xxix] The latter is clearly the better arrangement because the insurance company will not benefit by writing policies purchased by those without insurable interests. If the policy just becomes void, the insurance company has a big incentive to write such policies: it collects premiums and will never have to pay out on the policy. In a commentary accompanying its insurable interest statute the Wisconsin statutory compilation notes that

> [t]he best way to discourage insurers from issuing insurance policies to persons without insurable interest is to make them pay if they do, not to permit them to freely issue such policies knowing that they have a good public policy defense that lets them off the hook whenever a loss occurs. The court should have the power to order the proceeds paid as justice dictates.[xxx]

Furthermore, some state courts have held that insurance carriers are liable in negligence for issuing policies to people with out an insurable interest in the insured.[xxxi]

Only a minority of the statutes described above require employers with an insurable interest in their employees to obtain the consent of the individuals being insured.[xxxii] Among those that do, only Oklahoma specifies that the employee's consent must be sought and obtained before a life insurance policy is purchased.[xxxiii]

Most of the statutes require that the insurable interest exists at the time the life insurance policy first goes into effect, but it does not have to exist at the time the loss occurs.[xxxiv] That is, a corporation can continue to insure and remain the beneficiary of an employee who has been fired, who has resigned, or who has retired.

Some states have created an insurable interest for employers in their employees' lives only when the proceeds from policies are used to support employee benefit plans. Kentucky, for example, permits an employer to obtain life insurance on the life of an employee with itself as beneficiary only "for the purpose of funding a pension or other benefit plan established for the employee."[xxxv] Maine has determined that a corporation has an insurable interest in the lives of its employees past and present only for the purpose of funding aggregate employee benefit plans.[xxxvi] The Maryland, Missouri, Rhode Island, and Virginia statutes require that the amount of the insurance on non-management or retired employees not exceed an amount commensurate with employer-provided benefits.[xxxvii]

New York puts the most specific restrictions on corporations that want to insure the lives of non-management employees. Its statute creates a corporate insurable interest in employees or retirees who are eligible to participate in an employee benefit plan, but it requires: (1) the corporation to notify "prospective insureds in writing that coverage is being obtained on their lives;" (2) "prospective insureds' consent in writing to such coverage;" (3) corporate notification to terminated employees of their right to have the coverage terminated unless they have or will have the right to receive any employee benefit that is financed by the life insurance coverage; (4) corporate notification to terminated employees whose benefits terminate that they have the right to have the coverage terminated.[xxxviii] If the insurer changes, the insureds must be informed of the change.[xxxix] In addition, during the first five years after the corporation has obtained life insurance on employees, it may not use the policies as collateral for loans except in the case of unforeseen losses or financial obligations.[xl] The commentary accompanying the legislation that became effective in 1996 specifically notes that the purpose of allowing corporations to insure the lives of non-management employees is to help "employers in developing innovative means of financing employee health and other benefits in the best interests of the working people of this state."[xli] The legislation was "not intended to authorize . . . 'leveraged' COLI," to permit employers to improve their earnings by borrowing against the policies at reduced rates, and then reaping the benefits of tax deductions and payouts upon the deaths of the insured employees.[xlii] In carrying out the statutory intent, the State Department of Insurance requires any corporation using a COLI product to submit a letter stating the basis for determining insurable interest and explaining how conditions satisfying the basis will be verified.[xliii] Usual bases would be to fund an employee benefit plan including, for example, post-retirement health benefits, or a plan for key persons.[xliv] The letter must also include the notice, consent, and right to termination forms that will be given to employees.[xlv] The letter must also confirm that for employee benefit plan COLI, the total amount of insurance coverage will not exceed the costs of the program, or for key person COLI , the steps the corporation will take to insure that the amount of insurance will not exceed "the estimate of the potential loss that the corporation would incur from the untimely death of the key employee."[xlvi]

Although the concept of "insurable interest" has long been considered an important requirement for creating a valid insurance policy, it is not particularly effective in protecting employees and shareholders from corporate abuse in insuring the lives of rank-and-file employees. The unique Texas regimen of having an insurable interest created merely, but only, by the insured's consent is a much better way of protecting employees from having their lives, or more specifically their deaths, used in ways they find offensive.[xlvii] In addition, Texas Department of Insurance guidelines note that "[w]hen a person is no longer eligible to be a member of the group, the person should no longer be insured."[xlviii] Prohibiting corporations from maintaining life insurance on former employees certainly carries out the public policy of eliminating "temptations to the party interested to bring about, if possible, the event insured against."[xlix] Corporations receive no benefit from the continued life of former employees.

III. Employees' Rights and Consent

Because Texas law supports the position that COLI policies are unreasonable and unfair if they are taken out on the lives of non-key employees without their consent, courts in Texas have been the forums for lawsuits seeking to void such policies and obtain the insurance proceeds for the estate of the deceased employee. The plaintiffs' theory of these cases has been based on the corporations' lack of an insurable interest in the lives of their non-key employees. Although Texas statutes have not been as explicit as those in other states, Texas courts have routinely held that '[i]t is against the public policy of this state to allow anyone who has no insurable interest to be the owner of a policy of insurance upon the life of a human being."[l]

In a case decided last year by the United States District Court for the Southern District of Texas, the estate of a deceased former employee of Wal-Mart sued Wal-Mart and its insurer to obtain the proceeds of an insurance policy that Wal-Mart had taken out on the life of the employee, Douglas Sims, naming itself as beneficiary.[li] In 1993 through 1995 Wal-Mart bought about 350,000 COLI policies (through a trust it had created to buy and be the beneficiary of the policies) on the lives of its employees.[lii] When Sims died, his estate sued Wal-Mart to recover approximately $64,000 in death benefits payable under one of those policies, and it was successful.[liii] The estate claimed that Wal-Mart had no insurable interest in Douglas Sims's life.[liv] The court reiterated the Texas Supreme Court's longstanding common law rule that one can have an insurable interest in the life of another only when: (1) there is such a close relation "'by blood or affinity that [one] wants the other to continue to live, irrespective of the monetary considerations;"[lv] or (2) one is a creditor; or (3) one has "a reasonable expectation of pecuniary benefit or advantage from the continued life of another."[lvi] The last category, according to the Texas Supreme Court

> is determined by monetary considerations, viewed from the standpoint of the beneficiary. Would he . . . enjoy more substantial economic returns should the insured continue to live; or would he have more, in the form of the proceeds of the policy, should he die. . . . [If the beneficiary] would profit by [the insured's] death, the policy is void . . . since the public has a controlling concern that no person have an interest that may give rise to a temptation to destroy [the insured's] life.[lvii]

In other words, the employee must be so important that the success of the enterprise might be compromised by his or her death.[lviii] A mere employer-employee relationship is insufficient to give rise to an employer's insurable interest in the employee.[lix] Sims was not an officer, director, or shareholder of Wal-Mart; he was a mere employee.[lx] The court noted that it was "obvious" and "[c]ommon sense" that not all 350,000 Wal-Mart employees whose lives Wal-Mart had insured "could have been individuals that the company looked to 'primarily for the success of the business.'"[lxi] Because Wal-Mart failed to demonstrate Sims's specific importance to the company, the court rejected its assertion that it had an insurable interest in Sims.[lxii] The court also rejected Wal-Mart's claim of an insurable interest based on its need to defray the costs of replacing an employee who dies; insurable interest is based on the pecuniary value that the employee contributes when alive.[lxiii] In arriving at these conclusions, the district court relied on several Texas Supreme Court decisions[lxiv] and two recent Texas Courts of Appeals decisions, one which was not appealed to the Supreme Court[lxv] and the other which had its appeal denied by the Supreme Court.[lxvi]

Finally, the district court referred to public policy in Texas as evidenced by the Texas Legislature's grant to individuals of the right to decide who their insurance beneficiaries would be and to select and approve in writing any third party owner of insurance on their lives.[lxvii] Wal-Mart did not ask for Sims's consent or obtain his approval in writing as required by Texas statute.[lxviii] Wal-Mart did send flyers to its store managers briefly describing its new program, but there was no evidence that the managers or rank-and-file employees ever received them.[lxix] Moreover, the flyer contained only an "opt out" form that would eliminate any way for Wal-Mart to obtain evidence that a worker actually received the flyer or understood it, clearly an abridgment of Texas public policy which requires an informed choice on the part of employees as to whether their employer should be the owner and beneficiary of insurance policies on their lives.[lxx]

Wal-Mart has discontinued its COLI program for non-key employees.[lxxi] That should be the outcome for all such COLI programs. Unless employees are comfortable with the notion that most of us would be worth more dead than alive to our employers, and that is probably not a comforting thought, COLI programs without informed consent for rank-and-file employees should be outlawed in every state as they are being in Texas. In fact, members of the Corporate Owned Life Insurance Working Group of the National Association of Insurance Commissioners, a voluntary organization of the chief insurance regulatory officials of the fifty states, the District of Columbia, and the four U.S. territories, recommended in September 2002 that state laws should be amended to require notice and an affirmative consent requirement for COLI.[lxxii]

On the federal level, Representative Gene Green of Texas, outraged that corporations are profiting from the deaths of their employees and former employees, has introduced a bill in Congress, the Life Insurance Employee Notification Act,[lxxiii] that would eliminate some of the secrecy that exists about COLI.[lxxiv] The Act would require companies to inform employees that an insurance policy has been purchased on their lives, who the insurer is, what the benefit amount is, and who the beneficiary of the policy is.[lxxv] Although the Act would be an improvement over the protections employees have now, it does not go far enough because it does not require the employees' consent. Meaningful, informed consent, with a well-enforced prohibition on retribution for failure to consent, is the only way to protect the rights of employees to control who benefits from their deaths.

IV. Tax Implications

COLI plans have become favored arrangements for corporations in large part because of their tax advantages. First, beneficiaries of life insurance policies receive the death benefits free of income tax.[lxxvi] Second, the cash value builds up in a life insurance policy tax deferred and sometimes never paid.[lxxvii] Third, withdrawals from the cash value build-up are treated as withdrawals from basis first and then from earnings, so those first withdrawals up to basis are also not taxable.[lxxviii] Fourth, it is the strange, but usual, custom in the insurance industry that insurance policy loans are not considered withdrawals of cash from the value of the build-up within the policy itself; but rather loans from the insurance company with the policy's cash value serving only as collateral for the loan.[lxxix] The proceeds of those loans are not taxable because loan proceeds are not considered income under the tax code.[lxxx] Finally, interest on loans taken with the cash value of life insurance policies as collateral were often tax deductible.[lxxxi]

To allow businesses to take full advantage of these tax benefits, the insurance industry created a variety of plans, adapting them as the tax laws changed, whose main purpose was to maximize the interest deductions.[lxxxii] Without the interest deduction, some of these plans would not have been profitable to the businesses, in spite of the tax advantages given to the build-up within the policies and the death benefits.[lxxxiii] In 1964 Congress attempted to limit this tax arbitrage in plans contemplating "the systematic direct or indirect borrowing of part or all of the increases in the cash value of such [life insurance] contract[s],"[lxxxiv] but deductions were still allowed where "no part of 4 of the annual premiums due during the [first] 7-year period . . . is paid under such plan by means of indebtedness."[lxxxv] The Tax Reform Act of 1986 attempted to limit these tax advantages further by imposing a limit of $50,000 per-insured-employee on the amount of life insurance policy indebtedness for which interest may be deducted.[lxxxvi]

In 1996 Congress again tightened this deduction loophole on COLI loans.[lxxxvii] The House Report on the change noted that a "general principle of accurate income tax measurement under an income tax system provides that expenses, such as interest, are not deducted from income if they are costs of accretions to wealth that are not included in income."[lxxxviii] The House Committee noted "that it [was] not appropriate to permit a deduction for interest that is funding the increase in value of an asset of which the [corporation owning the policy] is the ultimate beneficiary, as recipient of the proceeds upon the insured [employee's] death."[lxxxix]

The Internal Revenue Code still allows a corporate deduction for "all interest paid or accrued within the taxable year on indebtedness."[xc] However, a tax deduction will be allowed for interest on COLI loans in only three of any seven-year period.. This "4-of-7 safe harbor was designed specifically to recognize the importance of borrowing on policies for 'other than tax saving purposes.'"[xci] The safe harbor does not apply, however, if the COLI program is a sham.[xcii] The sham-transaction doctrine provides that a transaction is not entitled to respect in assessing tax if it serves no business purpose other than generating tax benefits.[xciii] A "taxpayer can legitimately structure a transaction to minimize tax liability . . . , [but] the transaction must nevertheless have factual and economic substance."[xciv]

Because the new limits on COLI interest deductions did not grandfather in plans already in place, the Internal Revenue Service (IRS) started disallowing these deductions that had been taken in prior years, asserting the sham doctrine.[xcv] In August 2001 the IRS implemented a settlement plan that permitted businesses with COLI programs to settle with the IRS if they conceded eighty percent of the interest deductions they had taken for interest on loans associated with COLI.[xcvi] The IRS reached settlements with a variety of companies under the plan. For example, the IRS reached a settlement with R.R. Donnelly & Sons Co. that called for the company to pay the IRS $150,000,000, representing part of the taxes on all prior deductions on loans secured by COLI polies plus interest.[xcvii] In 2002, in reaction to the notable successes the IRS had in persuading courts to affirm the deduction disallowances in suits brought by CM Holdings,[xcviii] Winn-Dixie,[xcix] and American Electric Power to have the disallowances set aside,[c] the IRS terminated its settlement initiative with respect to leveraged COLI plans.[ci] Companies had until the beginning of 2003 to participate in the settlement program by agreeing to give up eighty percent of the COLI deductions they had claimed.[cii] There were about a hundred other companies including American Greetings Corp., W.R. Grace, Hershey Foods, Proctor & Gamble, Western Resources, and Hillenbrand Industries that were involved in disputes with the IRS about COLI-related deductions.[ciii] Some estimate these back taxes could amount to $6 billion.[civ] Others have said the sum could be much greater than that, and the investigation could involve 700 companies.[cv] American Greetings, for example, recorded a charge in 2001 of $143 million for possible exposure to an IRS disallowance of COLI interest deductions.[cvi] W.R. Grace noted a similar exposure of $57 million resulting from its deducting $163 million in COLI interest payments after 1992.[cvii]

Inspired by its three big wins in *Winn-Dixie*, *In re CM Holdings*, and *American Electric Power*, the IRS also began using an unusual and comprehensive set of information document requests when auditing banks that had BOLI programs.[cviii] The American Bankers Association (ABA) warned banks that these audits were not routine inquiries but preparation for litigation involving favorable tax treatment of BOLI.[cix] The ABA cautioned banks to pay particular attention to insurable interest and economic substance in their BOLI plans.[cx] It noted the IRS' public concern when a "'29 year old employee who is making $30,000 and is insured under a BOLI policy for $4 million.'"[cxi] In such a case it foresaw the IRS' asserting that "policy coverage far in excess of the risk of loss of the bank may belie the intended business purpose for purchasing policies."[cxii] The ABA was concerned about the IRS' search for documentation for the non-tax business purposes for purchasing BOLI and warned banks, in light of the IRS' recent successes in courts in COLI cases, to have the relevant documents available.[cxiii]

In 2003, however, the IRS suffered a setback when the United States District Court for the Eastern District of Michigan ordered it to pay Dow Chemical Company (Dow) more than $22 million plus interest and costs for deductions it improperly disallowed for interest and expenses Dow claimed on its 1989, 1990, and 1991 tax returns in connection with its COLI plans.[cxiv] In 1988 Dow purchased COLI policies on the lives of 4,051 upper management employees.[cxv] In 1991 Dow purchased COLI on the lives of 17,061 additional employees.[cxvi] The Dow COLI plans were similar to the plans in the Winn-Dixie, CM Holdings, and American Electric Power cases in that they all involved cash value policies, premium payments over a relatively short period, highly leveraged premium financing without loans in years four through seven, and they were all used to fund future benefit obligations.[cxvii] Nevertheless, the differences between the latter three plans and the Dow plan were significant enough for the courts in the latter three cases to hold that those plans were economic shams, and the Dow court to hold that "there was an economic benefit that could be derived from the plans without relying solely on the tax deductions for policy loan interest[, namely,] . . . providing a source of cash to cover unfunded future medical obligations for its retirees."[cxviii]

Dow became interested in COLI in 1989 when the Financial Accounting Standards Board (FASB) issued Exposure Draft 105, Employer's Accounting for Post Retirement Benefits Other than Pensions which, when adopted in 1990, required employers to accrue current liabilities for retiree medical and life insurance benefits on a current basis on their financial statements.[cxix] Dow had been accounting for its retiree medical benefits on a pay-as-you-go basis, and now under FAS 106 Dow had accrued retiree medical liabilities of $1.34 billion.[cxx] It planned to use COLI to fund these liabilities.[cxxi] In 1990 Michigan had enacted a statute that created an employer's insurable interest in the lives of non-key employees and retirees up to the level of the employer's projected unfunded benefit liabilities.[cxxii] Dow sought the consent of its employees for participation in its COLI program, encouraging consent by offering each employee a $5,000 death benefit.[cxxiii]

The IRS disallowed Dow's tax deductions on its loans to pay the premiums for its COLI reasoning that the only economic benefit from the plans was the tax deduction and, therefore, the plans were economic shams not entitled to the deductions.[cxxiv] Although taxpayers are allowed to reduce their tax obligations by any legal means, transactions whose only purpose is to create tax deductions and that have no other economic substance, are not recognized by the government, are considered shams, and will not support tax deductions.[cxxv] The court in *Dow* determined that unlike the other cases, Dow had pre-purchase illustrations that indicated a positive cash flow from the plan even without tax deductions for loan interest.[cxxvi] Furthermore, in the other three cases the courts found that the plans eliminated all risk by retrospectively "truing up" the cost of insurance and the death benefits paid out each year so that they were equal.[cxxvii] Thus, all risk is eliminated making the COLI transaction meaningless as far as providing insurance.[cxxviii] This did not occur in the Dow plan, according to the court and, therefore, the COLI was not a sham.[cxxix]

Even if successful, the IRS attack on the deductibility of interest on COLI loans does not end COLI tax benefits for corporations. Corporate owners of COLI still build up tax-free gains in the policies, and they receive tax-free death benefits when their employees die, even if they have not been employees for many years.[cxxx] The Treasury Department has estimated that the tax exemption on COLI earnings will cost taxpayers $9.3 billion in lost revenue each year for the next five years.[cxxxi]

V. PROFITING FROM COLI

The Texas Wal-Mart case discussed above just begins to suggest the huge numbers of employees who are affected by COLI abuses. Nestle USA has policies on the lives of 18,000 employees; Pitney Bowes Inc. on 23,000; Proctor & Gamble Co. on 15,000; American Electric Power Inc. on 20,000.[cxxxii] One insurance company attorney has estimated that between five and six million workers in the United States are covered by such insurance policies, and that about a quarter of the Fortune 500 companies have them.[cxxxiii]

COLI has become an efficient profit center for companies. One estimate has corporations earning up to sixteen percent of their profits from "janitor's insurance."[cxxxiv] Not only do the policies yield tax-free income as their investment value rises, but companies also use that value as collateral when they need to borrow to raise cash.[cxxxv] For example, Public Service Company of New Mexico bought COLI policies for hundreds of employees when it needed to raise money to take its nuclear power plants out of service.[cxxxvi] Then, of course, there is the death benefit when the employee dies, which the corporation can use for any purpose it chooses. Businesses find out when retired or other former employees die by having the firms that manage the COLI policies for them do "death runs" of Social Security numbers every quarter.[cxxxvii] Then they obtain the death certificates and send them to their insurance carrier.[cxxxviii] CM Holdings, for example, had COLI policies for at least 1,400 employees in 1990.[cxxxix] Younger workers would typically generate between $400,000 and $500,000 in death benefits; older workers would generate between $120,000 and $200,000.[cxl] A CM Holdings administrative assistant, for example, died in 1998 at age 62.[cxli] Her family received a death benefit of $21,000 provided under an employee benefit program while CM received a COLI benefit of $180,000.[cxlii] A CM music store worker died in 1992 at age 29 of AIDS providing CM with a death benefit of about $340,000.[cxliii]

One COLI arrangement that is particularly galling to workers, is the one created by Portland General, an Enron subsidiary.[cxliv] About seventy-five percent of an estimated $80 million in benefits from the policies pays for a long-term compensation plan for managers, directors, and other top officers; the other twenty-five percent contributes to a supplemental executive retirement plan.[cxlv] Workers who have had their entire retirement funds of hundreds of thousands of dollars wiped out by Enron's collapse were shocked to discover that their deaths will support benefit plans for top Enron executives.[cxlvi]

Banks have also become significant purchasers of life insurance (bank-owned life insurance: BOLI).[cxlvii] Wachovia Corp., for example, has BOLI policies insuring the lives of about 20,000 of its employees,[cxlviii] constituting about a fourth of its workforce; the policies generate about three percent of the bank's operating earnings.[cxlix] KeyCorp of Cleveland and Sovereign Bancorp of Philadelphia generated about twelve to fifteen percent of their net income from BOLI policies.[cl] Washington Mutual has more than $1.3 billion of BOLI policies.[cli] Bank of America, J.P. Morgan Chase, and Bank One have billions of dollars of BOLI policies on the lives of present and former employees.[clii] One financial services analyst has estimated that about a quarter to a third of the nation's publicly traded banks have BOLI policies on their employees.[cliii]

By federal statute, national banks are permitted to purchase and hold an interest in life insurance as an "exercise [of] incidental powers as shall be necessary to carry on the business of banking."[cliv] The Office of the Comptroller of the Currency (OCC) issues guidelines so banks can correctly interpret the statute to determine if they can legally purchase particular insurance products.[clv] A 1991 OCC circular[clvi] clearly indicated that there was no federal statutory authority for national banks to purchase life insurance for their own account as an investment.[clvii] In 1996 the OCC issued new guidelines for national banks instructing that "[a] purchase of life insurance is incidental to banking, and . . . therefore, legally permissible, if it is convenient or useful in connection with the conduct of the bank's business."[clviii]

When businesses use COLI (or BOLI) to fund employee benefit plans (as some state statutes mandate as the only way for businesses to have the required insurable interest in non-key employees[clix]), they generally use one of two methods to determine the amount of insurance needed to finance the plans. Using the recovery method, the business projects the amount that will be owed to employees as benefits and determines its present value.[clx] The business then purchases enough life insurance on the lives of employees so that the gain from the insurance proceeds reimburses the business for the benefit payments.[clxi] In the cost offset method, the business projects the annual expense of the benefit plan and purchases enough insurance on the lives of employees so that the income earned on the cash surrender value offsets the benefit expense.[clxii] When the business collects death benefits, they just enhance the business' bottom line.[clxiii]

Employees and shareholders are generally uninformed about these COLI and BOLI programs because the Securities and Exchange Commission (SEC) and the OCC do not require specific disclosure about them, and state insurance departments do not require disclosure either.[clxiv] For example, the OCC requires national banks to record their interest in the cash surrender value of BOLI policies as an "other asset."[clxv] The increase in the cash surrender value over time is recorded as "other non-interest income."[clxvi] There is no easy way for an interested person to know that these additions to an enterprise's bottom line come from life insurance policies. A result of the secret nature of these programs is that shareholders can be misled about the success of the businesses in which they have invested. Businesses can disguise poor results in their core enterprises by substantial additions to their bottom lines of death benefits and the tax-free build-up of funds in insurance policies.

To facilitate these arrangements, a small California banking systems design firm, Bancorp Services, has created a new life insurance administration system through which large companies with a great deal of money invested in COLI policies can minimize the effect of short-term market volatility on the companies' bottom lines.[clxvii] The system allows the company to report a "smoothed value on its quarterly profit and loss statements."[clxviii] Its insurer records the policies' market value separately from their "smoothed 'book' value [and] the company records the increase in the smoothed book value to its income statement each year."[clxix] The fact that Bancorp's system has been in great demand suggests the widespread use of COLI policies to impact company profits rather than, merely, to protect the company from financial losses due to the deaths of employees or to cover the costs of employee benefit programs. Bancorp has been involved in litigation with the Hartford Life Insurance Company, a former client, Metropolitan Life Insurance Company, and Sun Life to determine who has rights to the system.[clxx]

Businesses purchasing COLI are not the only ones profiting from the arrangement. Insurance companies aggressively market COLI, and in recent years it has comprised about twenty-five to thirty percent of all new life insurance sales.[clxxi]

VI. Split-Dollar Insurance

Businesses use insurance in another way that keeps shareholders and others from understanding the true nature of the transactions. In a split-dollar scheme, the executive (or an insurance trust created for the executive) owns a permanent life insurance contract.[clxxii] The executive chooses the policy beneficiary.[clxxiii] The term "split-dollar" refers to the arrangement whereby the corporation pays most of the premiums on the policy, and the executive makes a small contribution to the premium payments.[clxxiv] The executive can use the value that builds up in the policy. When the executive dies, the corporation gets back the money it has advanced for premiums, and the executive's estate gets the remainder of the death benefit, free of estate and income taxes.[clxxv] Split-dollar policies have several important advantages for executives: (1) the policies are more secure than pensions because the latter are backed only by corporate promises, whereas the policies are backed by a regulated insurance company; (2) the executives own the policies outright and, therefore, can take the policies with them when they leave the company; (3) if the company goes into bankruptcy, creditors do not have any rights to the policies, in contrast to the vulnerability of pension plan assets; (4) the executive can choose how the policy's cash value is invested; (5) the split-dollar arrangement hides large amounts of executive compensation because the policies are valued in corporate filings as having the same value as term life insurance policies which, in reality, are worth a small fraction of the whole or universal life insurance policies in the split-dollar arrangement; and (6) the executives pay tax only on the term value of the policy.[clxxvi]

Enron had created a split-dollar arrangement for its former Chief Executive (CEO) Kenneth Lay who received a $12 million life insurance policy with the corporation contributing $1.25 million in insurance premiums.[clxxvii] GE also paid for a split-dollar policy for its former CEO and chairman Jack Welch.[clxxviii] John W. Snow, the new Secretary of the Treasury and former CEO and chairman of CSX Corporation, had a split-dollar agreement under which CSX promised in 2001 to buy him a $25 million life insurance policy within seven years.[clxxix] When Snow left CSX to become Treasury Secretary, the company had not yet bought the insurance policy; instead the CSX will pay Snow $5 million, the amount needed to buy about $25 million of life insurance.[clxxx] Significantly, the Treasury Department is considering new regulations that could result in a ban on split-dollar agreements,[clxxxi] but the insurance industry is lobbying vigorously to protect these arrangements.[clxxxii] Snow characterized the lump-sum payment he is to receive in lieu of the split-dollar insurance policy as a step to avoid a conflict of interest.[clxxxiii] Former Treasury Secretary Paul O'Neill had a split-dollar life insurance policy for which his corporation, Alcoa, had paid $891,000 in premiums.[clxxxiv] His federal disclosure form listed the value of the policy as between $250,000 and $500,000, but SEC filings state that the policy would add about $750,000 a year to O'Neill's pension in retirement.[clxxxv]

Split-dollar policies have become a major method of giving top corporate executives tax-free pay and loans, and death benefits to their heirs, hidden from shareholder scrutiny.[clxxxvi] Other companies that have split-dollar agreements with their top executives include Equifax, General Motors, H.J. Heinz, and Unifi.[clxxxvii]

Charities have also been involved in split-dollar arrangements in which donors make a donation to a charitable organization for which they receive a tax deduction, and then the charity uses part of those funds to buy life insurance policies for the benefit of the donor.[clxxxviii] The IRS outlawed this scheme in 1999 as an abusive tax shelter.[clxxxix]

Some critics forecast the demise of split-dollar arrangements because of the enactment of the Sarbanes-Oxley Act of 2002.[cxc] The Act, whose purpose is to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws,"[cxci] prohibits corporations from making loans to directors or executive officers.[cxcii] The purpose of the prohibition is to prevent directors and executive officers from obtaining favorable loans from the corporation at the expense of the shareholders.[cxciii] If access to the build-up within the policy is deemed a loan, then it would now be banned. Moreover, if each premium payment is considered a material modification of the loan, then split-dollar plans existing at the time of the Act's enactment would not be grandfathered and, thus, would be in violation of the law.[cxciv] Violations of the Act are punishable as criminal offenses.[cxcv] Leading corporate law firms seem unsure whether Sarbanes-Oxley does, in fact, cover the split-dollar insurance plans.[cxcvi] If it does, shareholders would be well served because split-dollar schemes serve no purpose but to hide executive compensation.

VII. Conclusion

It is unseemly for businesses to benefit from the deaths of their employees, some of whom may have been terminated many years before, without the employees having agreed to the arrangement or, in fact, even knowing about it. The Rev. Jesse Jackson analogized COLI policies to those slave holders purchased on the lives of their human property.[cxcvii] That is a particularly dramatic and distasteful comparison, but modern-day COLI may actually be worse. Considering the importance of many slaves to the households as well as to the commercial enterprises of the slave holders, it is probable that many slaves were worth more to their masters alive than dead. On the other hand, individually, each of the 300,000 rank-and-file employees whose lives were insured by Wal-Mart had little or no impact on the fortunes of their employer, and would be worth more to Wal-Mart dead than alive.

Basic public policy in every state is that one should not be able to insure the life of another when that person is worth more to the beneficiary dead than alive. At the very least, to protect an employee's interest in his or her own life, no employer should be able to insure the life of an employee, naming the employer as beneficiary, without the informed consent of the employee. In fact, in light of indications of societal breakdowns of family and "love and affection" relationships, no person should be the object of any life insurance policy without his or her consent.

Some states decided to make an exception to this basic public policy concern when the purpose of COLI plans is to fund employee benefit plans. This exception, however, does not only impose on employees and former employees; it creates a tremendous imposition on taxpayers when the federal trend is to relieve taxpayers of employee-benefit burdens. At the same time that the federal government is encouraging the privatization of retirement benefits, COLI does exactly the opposite, secretly, so the taxpayer will not know about it. Companies are funding their employee benefit plans with the tax-free income that builds up in COLI and with the tax-free pay-outs they receive when the insured employees die. They are shifting their responsibility for their employees' benefits programs to the taxpayer. What President Bush has said he wants, is for the government to pay less and the private sector to pay more. If that is truly the goal, then the tax advantages that COLI currently enjoys have to be eliminated. Currently, the costs of COLI to the taxpayer is more than the cost of the tax breaks the government gives to encourage economic empowerment zones ($9.3 billion compared with $7.2 billion over five years) or the cost of the deductions for interest on student loans ($3.5 billion over five years).[cxcviii]

Finally, the SEC has to require clear and specific disclosure of profits earned from COLI programs and of executives' actual benefits from insurance programs. The shareholder has a right to know how much top management is earning in total and whether the strength of publically traded companies comes from its core businesses or from some financial scheme involving COLI.

Footnotes

i.Am. Elec. Power v. United States, 136 F. Supp. 2d 762, 768 (S.D. Ohio 2001), *aff'd*, 326 F.3d 737 (2003).

ii.*Id.*; *see also infra* notes 75-82 and accompanying text.

iii.*Am. Elec. Power*, 136 F. Supp. 2d at 768.

iv.Pub. L. No. 99-514, § 1003, 100 Stat. 2085 (codified as amended at 26 U.S.C. § 264(a)(1) & (e)(1)).

v.H. REP. NO. 102-432, at 61 (1992).

vi.149 CONG. REC. E76-02 (daily ed. Jan. 28, 2003) (statement of Rep. Gene Green of Texas).

vii.Ellen E. Schultz & Theo Francis, *The Economy: Senator to Target Tax Boon to Firms Insuring Workers*, WALL ST. J., May 3, 2002, at A2.

viii.149 CONG. REC. E76-02, *supra* note 4.

ix.*See, e.g.*, Ellen E. Schultz & Theo Francis, *Many Banks Boost Earnings with 'Janitors' Life Insurance*, WALL ST. J., Apr. 26, 2002, at A1 (noting that many banks in the United States buy life insurance policies on the lives of their ran-and-file employees (BOLI)); Ellen E. Schultz & Theo Francis, *Valued Employees: Worker Dies, Firm Profits*, WALL ST. J., Apr. 19, 2002, at A1 (noting that millions of current and former employees at hundreds of large companies are covered by COLI).

x.*See infra* notes 138-39 and accompanying text.

xi.*See, e.g.*, Ellen E. Schultz & Theo Francis, *Top Executives at Enron Shield Pension Benefits*, WALL ST. J., Feb. 7, 2002, at A3.

xii.Ellen E. Schultz & Theo Francis, *Dying to Donate: Charities Invest in Death Benefits*, WALL ST. J., Feb. 6, 2003, at B1.

xiii.*See, e.g., supra* notes 6, 8, 10, and 11.

xiv.*See infra* notes 91-103 and accompanying text. *But see* Dow Chem. Co. v. United States, No. 00-10331-BC, 2003 WL 1701521 (E.D. Mich. Mar. 31, 2003) (ordering the IRS to return to Dow over $22 million in deductions for interest on COLI policies after holding that the policies were not economic shams).

xv.United Sec. Life Ins. v. Trust Co. of Pa., 113 A. 446, 446 (Pa. 1921); *see also* Turner v. Davidson, 4 S.E.2d 814 (Ga. 1939).

An employer does not have "insurable interest" in life of employee solely because of relationship of

> employer and employee, but employer must have substantial economic interest in life of employee, and, by virtue of relationship, must reasonably expect to reap substantial pecuniary benefit through continued life of employee and to sustain consequent loss upon employee's death. . . . A small and insignificant readjustment, which would normally follow death of employee performing ordinary duties requiring no special skill or knowledge, will not give employer an "insurable interest" in life of employee. *Id.* at 814-15.

xvi.*See* Dow Chem. Co. v. United States, No. 00-10331-BC, 2003 WL 1701524, at *4 (E.D. Mich. Mar. 31, 2003).

xvii.Drane v. Jefferson Standard Life Ins. Co., 161 S.W.2d 1057, 1059 (Tex. 1942).

xviii.Warnock v. Davis, 104 U.S. 775, 779 (1881); *see also* Grigsby v. Russell, 222 U.S. 149, 154 (1911). Justice Holmes delivered the opinion of the Court noting that a "contract of insurance upon a life in which the insured has no interest is a pure wager that gives the insured a sinister counter interest in having the life come to an end." *Id.*

In 1884 the Supreme Court of Alabama said:

> There is no limit to the insurable interest which a man may have in his own life; but there are forcible reasons why a mere stranger should not be permitted to speculate upon the life of one whose continued existence would bring to him no expectation of possible benefit or advantage. . . . [W]ager policies, or such as are procured by a person who has no interest in the subject of insurance, are undoubtedly most pernicious in their tendencies, because in the nature of premiums upon the clandestine taking of human life. . . . [S]uch policies, if valid, not only afford facilities for a demoralizing system of gaming, but furnish strong temptations to the party interested to bring about, if possible, the event insured against.

Helmtag's Adm'r v. Miller, 76 Ala. 183 (1884).

Lower courts have noted that the "public policy against 'wager' policies is so strong that the carrier issuing such a policy may be liable for death or other injury to the insured resulting from the carrier's failure to exercise reasonable care in the issuance of the policy," that is, issuing it to one without an insurable interest. Burton v. John Hancock Mut. Life Ins. Co., 298 S.E.2d 575, 577 (Ga. Ct. App. 1982).

xix.*Warnock*, 104 U.S. at 775.

xx.Aetna Life Ins. Co. v. France, 94 U.S. 561, 564 (1876).

xxi.*See, e.g.*, ALA. CODE § 27-14-3(a) (2002); ALASKA STAT. § 21.42.020(d)(1) & (2) (Michie 2002); ARIZ. REV. STAT. § 20-1104(C)(1) & (2) (2002); ARK. CODE ANN. § 23-79-103(c)(1)(A) & (B) (Michie 2002); CAL. INS. CODE § 10110.1(a) (West 2002); DEL. CODE ANN. tit. 18, § 2704(c)(1) & (2) (2002); GA. CODE ANN. § 33-24-3(a) (2002); IDAHO CODE § 41-1804(3)(a) & (b) (Michie 2002); KY. REV. STAT. ANN. § 304.14-040(4)(a) & (b) (Banks-Baldwin 2002); ME. REV. STAT. ANN. tit. 24-A, § 2404(3)(A) & (B) (West 2002); MD. CODE ANN., Ins. § 12-201(b)(2)(i) & (b)(3) (2002); MISS. CODE ANN. § 83-5-251(3)(a) & (b) (2002); MONT. CODE ANN. § 33-15-201 (3)(a) & (b) (2002); NEV. REV. STAT. 687B.040(3) (2001); N.Y. INS. LAW § 3205(a)(1)(A) & (B) (McKinney 2002); N.D. CENT. CODE § 26.1-29-09.1(3)(a) & (b) (2001); OKLA. STAT. tit. 36, § 3604(C)(1) & (2) (2002); 40 PA. CONS. STAT. ANN. § 512 (West 2002); R.I. GEN. LAWS § 27-4-27(c)(1) & (2) (2001); S.D. CODIFIED LAWS § 58-10-4 (1) & (2) (Michie 2002); UTAH CODE ANN. § 31A-21-104(2)(a)(i)(A) & (B) (2002); VA. CODE ANN. § 38.2-301(B)(1) & (2) (Michie 2002); WASH. REV. CODE § 48.18.030(3)(a) & (b) (2002); W. VA. CODE § 33-6-2(c)(1) & (2) (2002); WYO. STAT. ANN. § 26-15-102(c)(i) & (ii) (Michie 2002). *But see* TEX. INS. CODE ANN. art. 3.49-1 § 3 (Vernon 2001) (having only a blanket rule that permits anyone of legal age to consent in writing to the purchase of insurance on his or her life by any other person or legal entity).

xxii.*Warnock*, 104 U.S. at 775.

xxiii.*See, e.g.*, ALA. CODE § 27-14-3(c)(2002); ARK. CODE ANN. § 23-79-103(c)(1)(D) (Michie 2002); CAL. INS. CODE § 10110.1(c) (West 2002); GA. CODE ANN. § 33-24-3(c) (2002);MASS. GEN. LAWS ch. 175, § 123A (2003); N.C. GEN. STAT. § 58-58-75 (2002) (granting any employer an insurable interest in the life of an employee for the benefit of the employer). *But see* DEL. CODE ANN. tit. 18, § 2704(c)(3) (2002) (stating that an employer that provides life, health, disability, retirement or similar benefits to employees (even if it is only to some of them) has an insurable interest in the lives of all its employees); IND. CODE § 27-1-12-17.1(c) (2002) (stating that "[a]n employer that provides life insurance, health insurance, disability insurance, retirement benefits, or similar benefits to an employee . . . has an insurable interest in the life of the employee"– but not, presumably, in the lives of all employees); 40 PA. CONS. STAT. ANN. § 512 (West 2002) (permitting corporations to insure the lives of employees without any qualifying requirement based on the employees' financial value to the corporation).

xxiv.3 COUCH ON INSURANCE § 43.13 (1995).

xxv.Ellen E. Schultz & Theo Francis, *Why Are Workers in the Dark?*, WALL ST. J., Apr. 24, 2002, at C1.

xxvi.*See, e.g.*, ALA. CODE § 27-14-3(d)(2002); ARIZ. REV. STAT. § 20-1104(C)(4) (2002); ARK. CODE ANN. § 23-79-103(c)(2)(A) (Michie 2002); CAL. INS. CODE § 10110.1(f) (West 2002); COLO. REV. STAT. § 10-7-115 (2002); FLA. STAT. ch.

627.404(2) (2002); IOWA CODE § 511.39 (2001) KANS. STAT. ANN. § 40-450(b) (2001); MINN. STAT. § 61A.073 (2002); MONT. CODE ANN. § 33-15-201 (5) (2002) (requiring that insurance is purchased with the insured individuals's contributions); NEB. REV. STAT. § 44-704(4) (2002); N.M. STAT. ANN. § 59A-18-5 (2002); N.D. CENT. CODE § 26.1-29-09.1(3)(d) (2001); OKLA. STAT. tit. 36, § 3604(D) (2002); S.D. CODIFIED LAWS § 58-10-4 (4) (Michie 2002); VA. CODE ANN. § 38.2-301(b)(4) (Michie 2002); WASH. REV. CODE § 48.18.030(3) & (4) (2002); W. VA. CODE § 33-6-2(c)(4) (2002). *But see* MASS. GEN. LAWS ch. 175, § 123A(2) (2003) (stating that a charitable institution has an unlimited insurable interest in the life of any donor without requiring specific consent); N.Y. INS. LAW § 3205(b)(3) (McKinney 2002) (permitting a charitable institution to obtain life insurance on any person without requiring consent).

xxvii.Jennifer Schuessler, *Office Indemnity: Does Your Employer Want You Dead?*, BOSTON GLOBE, Mar. 9, 2003, at D3.

xxviii.*See, e.g.*, ALA. CODE § 27-14-3(f)(2002) (premium payments); CAL. INS. CODE § 10110.1(e) (West 2002) (nothing); N.J. STAT. ANN. § 17:35-11 (West 2002) (nothing).

xxix.*See, e.g.*, ALASKA STAT. § 21.42.020(b) (Michie 2002); ARIZ. REV. STAT. § 20-1104(B) (2002); ARK. CODE ANN. § 23-79-103(b) (Michie 2002); DEL. CODE ANN. tit. 18, § 2704(b) (2002); HAW. REV. STAT. § 431:10-204(C) (2002); IDAHO CODE § 41-1804(2) (Michie 2002); ME. REV. STAT. ANN. tit. 24-A, § 2404(2) (West 2002); N.Y. INS. LAW § 3205(b)(4) (McKinney 2002); OKLA. STAT. tit. 36, § 3604(B) (2002); OR. REV. STAT. § 743.024(2) (2001); R.I. GEN. LAWS § 27-4-27(b) (2001); WIS. STAT. § 631.07(4) (2001).

xxx.WIS. STAT. § 631.07 cmt. (2001).

xxxi.*See, e.g.*, Liberty Nat'l Life Ins. Co. v. Weldon, 100 So. 2d 696 (Ala. 1958); Bajwa v. Metropolitan Life Ins. Co., 776 N.E.2d 606 (Ill. Ct. App. 2002); Ramey v. Carolina Life Ins. Co., 135 S.E.2d 362 (S.C. 1964).

xxxii.*See, e.g.*, CAL. INS. CODE § 10110.1(c) (West 2002) (requiring consent but without definition); DEL. CODE ANN. tit. 18, § 2708 (2002) (requiring consent but without definition); 215 ILL. COMP. STAT. ANN. 5/224.1 (West 2002) (requiring consent and defining it as "written notice of the coverage and [not rejecting the coverage] within 30 days of receipt of such notice"); KANS. STAT. ANN. § 40-452(a) & (b) (2001) (requiring consent and defining it as written notice of the coverage and not rejecting the coverage within 30 days of receipt of such notice and noting that retaliation for refusal to consent is unlawful); MD. CODE ANN., Ins. § 12-201(b)(4)(ii)(A) (2002) (requiring written consent); MO. REV. STAT. § 376.531(2) (2002) (requiring consent and defining it as written notice of the coverage and not rejecting the coverage within 30 days of receipt of such notice); NEB. REV. STAT. § 44-704 (2002) (requiring written consent for anyone obtaining life insurance on another except that obtained by a spouse or a child); N.D. CENT. CODE § 26.1-29-09.1(3)(e)(2001) (requiring consent and defining it as written notice of the coverage and [not rejecting the coverage] within 30 days of receipt of such notice); OHIO REV. CODE ANN. § 3911.091 (Anderson 2002) (requiring consent and defining it as written notice of the coverage and not rejecting the coverage within 30 days of receipt of such notice and noting that retaliation for refusal to consent is unlawful); UTAH CODE ANN. § 31A-21-104(2)(a)(v)(B)(II) (2002) (requiring written consent).

xxxiii.OKLA. STAT. tit. 36, § 3604(C)(4)(b)(1) & (2) (2002). The Oklahoma statute also prohibits retaliation against an employee who refuses to consent. *Id.* at § 3604(C)(4)(c). In addition, the insurable interest of the employer is limited to either an amount agreed to by the employee or the amount the employee is entitled to under all employer benefit plans. *Id.* at § 3604(C)(4)(d).

xxxiv.*See, e.g.*, ALA. CODE § 27-14-3(e)(2002); CAL. INS. CODE § 10110.1(d) (West 2002); GA. CODE ANN. § 33-24-3(d) (2002); KANS. STAT. ANN. § 40-453 (2001); OKLA. STAT. tit. 36, § 3604(C)(4)(g) (2002); *see also* Ficke v. Prudential Ins. Co., 202 S.W.2d 429, 431 (Ky. Ct. App. 1947) (noting the general rule that "an insurable interest at the inception of a contract of life insurance is regarded by most courts as sufficient, and it is immaterial that such an interest ceases prior to the death of the insured).

xxxv.KY. REV. STAT. ANN. § 304.14-040(1) (Banks-Baldwin 2002).

xxxvi.ME. REV. STAT. ANN. tit. 24-A, § 2404(3)(D) (West 2002).

xxxvii.MD. CODE ANN., Ins. § 12-201(b)(4)(ii)(2)(B) (2002); MO. REV. STAT. § 376.531(3) (2002); R.I. GEN. LAWS § 27-4-27(c)(ii) (2001); VA. CODE ANN. § 38.2-301(B)(3) (and also requiring that employees other than key employees must have been employed for 12 consecutive months) (Michie 2002).

xxxviii.N.Y. INS. LAW § 3205(d)(1) (McKinney 2002).

xxxix.N.Y. INS. LAW § 3205(d)(4) (McKinney 2002).

xl.N.Y. INS. LAW § 3205(d)(5) (McKinney 2002).

xli.1996 N.Y. Laws 491 § 1.

xlii.*Id.*

xliii.N.Y. STATE DEPT. OF INS., GUIDELINES FOR CORPORATE-OWNED LIFE INSURANCE (Feb. 28, 2002) (available at www.ins.state.ny.us/acrobat/colich.pdf) (visited Mar. 17, 2003).

xliv.*Id.* at § II.A.2.

xlv.*Id.* at II.A.4.

xlvi.*Id.* at II.A.7.

xlvii.Furthermore, replacing "insurable interest" with "consent of the insured" as a prerequisite for insuring the life of another in all circumstances, including where there is a relationship the law would consider one of love and affection, is probably a good idea. Relationships of love and affection seem more fleeting than they once were. Consent of the insured might discourage a disaffected spouse, for example, from considering the benefits of his or her spouse's demise. There are many reported examples of one spouse killing the other "for the insurance money." *See, e.g.,* Leslie Brown, *Triad,* GREENSBORO NEWS & RECORD, DEC. 30, 2001, AT R1; Walter Griffin, *Jury Selection to Begin in Contract Murder*, BANGOR DAILY NEWS, July 27, 2002, at 5; Craig Jarvis, *Start of Trial Caps Months of Suspense,* NEWS & OBSERVER (Raleigh, NC), May 4, 2003, at A1; Jacqueline M. Jauregui, *Toxic Mold: Do Insurers Have a Duty to Warn Policyholders or Others of the Potential Health Risks?*, FICC Q., Oct. 1, 2001, at 191; Derek Jensen, *Witness Tells of Payoff for Slaying Allen's Wife*, DESERET NEWS, Feb. 9, 2000, at B4; *Week in Review; Nov.3-9*, WASH. POST, Nov. 10, 2002, at C4; *Wife Killed Lane for Insurance Policy, Prosecutor Says*, NAT'L POST, Aug. 26, 2000, at A17; *see also* Ramey v. Carolina Life Ins. Co., 135 S.E.2d 362 (S.C. 1964) (plaintiff alleging he sustained serious injuries when his wife poisoned him with arsenic in an attempt to collect on a $5000 life insurance policy she bought on his life without his knowledge or consent); *cf.* Liberty Nat'l Life Ins. Co. v. Weldon, 100 So. 2d 696 (Ala. 1958) (father alleging carrier's negligence in selling life insurance policy on life of his daughter, without his consent, to daughter's aunt who then murdered insured niece).

xlviii.TEXAS DEPT. OF INS., CORPORATE OWNED LIFE INSURANCE CHECKLIST (2002) (relying on TEX. INS. CODE ANN. arts. 21.24, 3.42(i)(2), 3.50 (Vernon 2002)).

xlix.Helmtag's Adm'r v. Miller, 76 Ala. 183 (1884).

l.Cheeves v. Anders, 28 S.W. 274, 275 (1894); *accord* Empire Life Ins. Co. of America v. Moody, 584 S.W.2d 855, 859 (Tex. 1979); Drane v. Jefferson Standard Life Ins. Co., 161 S.W.2d 1057, 1058-59 (Tex. 1942).

li.Mayo v. Hartford Life Ins. Co., 220 F. Supp. 2d 794, 796 (S.D. Tex. 2002).

lii.*Id.*

liii.*Id.*

liv.*Id.*

lv.*Id.* at 798 (citing Empire Life Ins. Co. of America v. Moody, 584 S.W.2d 855, 859 (Tex. 1979).

lvi.*Id.*

lvii.Drane v. Jefferson Standard Life Ins. Co., 161 S.W.2d 1057, 1059.

lviii.McBride v. Clayton, 166 S.W.2d 125, 128-29 (Tex. 1942).

lix.Stillwagoner v. Travelers Ins. Co., 979 S.W.2d 354, 358 (Tex. App. 1998). A mere employer-employee relationship is distinguished from the "key man" concept that was recognized by the Texas Legislature in 1921. Mayo v. Hartford Life Ins. Co., 220 F. Supp. 2d 794, 798 n.11 (S.D. Tex. 2002). The statute it enacted then, which was recodified in 1951, TEX. INS. CODE ANN. art. 3.49, allows a business to purchase and be the beneficiary of life insurance policies on officers or stockholders who are deemed significant to the ongoing success of the business. 220 F. Supp. 2d at 799.

lx.220 F. Supp. 2d at 799.

lxi.*Id.* at 800-01.

lxii.*Id.* at 802-03.

lxiii.*Id.* at 804.

lxiv.*Id.* at 805 (citing Empire Life Ins. Co. of America v. Moody, 584 S.W.2d 855 (Tex. 1979); McBride v. Clayton, 166 S.W.2d 125 (Tex. 1942); Drane v. Jefferson Standard Life Ins. Co., 161 S.W.2d 1057 (Tex. 1942)).

lxv.Stillwagoner v. Travelers Ins. Co., 979 S.W.2d 354 (Tex. App. 1998).

lxvi.Tamez v. Certain Underwriters at Lloyd's, London, 999 S.W.2d 12 (Tex. App. 1999).

lxvii.Mayo v. Hartford Life Ins. Co., 220 F. Supp. 2d 794, 806, 808 (S.D. Tex. 2002).

lxviii.*Id.* at 806.

lxix.*Id.* at 806-07.

lxx.*Id.* at 807 n.36, 808.

lxxi.L.M. Sixel, *Profiting from Death*, HOUSTON CHRON., Apr. 16, 2002, at 1.

lxxii.Press Release, National Association of Insurance Commissioners, Working Group Makes Recommendation on Corporate Owned Life Insurance Sales, Sept. 10, 2002, *available at* www.naic.org/pressroom/releases/rel02/091002_COLIpressrelease.htm.

lxxiii.H.R. 414, 108th Cong. (2003).

lxxiv.149 CONG. REC. E76-02 (daily ed. Jan. 28, 2003) (extension of remarks by Rep. Green).

lxxv.*Id.* A violation of the Act would be an "unfair method of competition and an unfair or deceptive act or practice under section 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1))." H.R. 414, 108th Cong. § 2(c) (2003).

lxxvi.I.R.C. §§ 72, 101(a)(1) (2002); *see In re* CM Holdings, Inc., 254 B.R. 578, 580 (D. Del. 2000), *aff'd* 301 F.3d 96 (3d Cir. 2002); Dow Chem. Co. v. United States, No. 00-10331-BC, 2003 WL 1701524, at *4 (E.D. Mich. Mar. 31, 2003).

lxxvii.I.R.C. § 72(e) (2002); *see In re* CM Holdings, Inc., 254 B.R. at 580.

COLI plans generally use one of two kinds of insurance policies. *Id.* at 584. A whole life policy has a term equal to the whole life of the insured, and the owner of the policy buys it from the insurance company by paying a fee called a premium. *Id.* at 583-84. The premiums paid, less an administrative expense charge that includes an additional margin for unanticipated expenses, are added to the cash value of the policy. *Id.* at 584. The cash value accrues interest. *Id.* The "inside build-up" in the policy enables the policy owner to take a policy loan from the insurance company, up to the cash value of the policy, using the cash value as collateral. *Id.* Meanwhile the encumbered cash value continues to earn interest. *Id.* The interest rate on the loan is set in the policy, and the loan does not have to be repaid because all the principal and interest on the loan can be deducted from the death benefit when the insured dies. *Id.* A universal life policy is like a whole life policy with some additional flexibility in annual premiums, death benefits, partial withdrawal of cash value, and interest rates. *Id.*

lxxviii.*Dow Chem. Co.,* 2003 WL 1701524 at *4.

lxxix.Am. Elec. Power, Inc. v. United States, 136 F. Supp. 2d 762, 780 (S.D. Ohio 2001), *aff'd*, 326 F.3d 737 (2003).

lxxx.I.R.C. § 61 (2002) (loan proceeds not included in list of items constituting gross income).

lxxxi.*See In re* CM Holdings, Inc., 254 B.R. at 580.

lxxxii.*In re* CM Holdings, Inc., 301 F.3d 96, 100 (3d Cir. 2002).

lxxxiii.*Id.*

lxxxiv.Revenue Act of 1964, Pub. L. No. 88-272 (codified as I.R.C. §264(a)(3)).

lxxxv.I.R.C. § 264(c)(1) (2002).

lxxxvi.H. REP. NO. 102-432, at 61 (1992) (referring to U.S.C. § 264(a)(1) & (e)(1)).

lxxxvii.Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104-191, 110 Stat. 1936, 2090.

lxxxviii.H. REP. NO. 104-280, at 303 (1995).

lxxxix.*Id.*

xc.26 U.S.C. § 163(a) (2002).

xci.*In re* CM Holdings, Inc., 301 F.3d 96, 106 (3d Cir. 2002) (citing S. REP. NO. 830 (1964)).

xcii.Winn-Dixie Stores, Inc. v. Comm'r, 254 F.3d 1313, 1316 (11th Cir. 2001), *cert. denied*, 122 S. Ct. 1537 (2002).

xciii.*Id.*

xciv.Am. Elec. Power, Inc. v. United States, 136 F. Supp. 2d 762, 778 (S.D. Ohio 2001), *aff'd*, 326 F.3d 737 (2003).

xcv.*See, e.g.*, Winn-Dixie Stores, Inc. v. Comm'r, 254 F.3d 1313, 1316 (11th Cir. 2001), *cert. denied*, 122 S. Ct. 1537 (2002); *In re* CM Holdings, Inc., 301 F.3d 96 (3d Cir. 2002); Am. Elec. Power, Inc. v. United States, 136 F. Supp. 2d 762 (S.D. Ohio 2001), *aff'd*, 326 F.3d 737 (2003); *see also* Ellen E. Schultz & Theo Francis, *Valued Employees: Worker Dies, Firm Profits*, WALL ST. J., Apr. 19, 2002, at A1.

xcvi.I.R.S. Announcement 2002-96, 2002-43 I.R.B. 756.

xcvii.R.R. Donnelley & Sons Co., *R.R. Donnelley Settles IRS Dispute over Corporate Owned Life Insurance Deductions* (Apr. 5, 2002), *available at* www.rrdonnelley.com.

xcviii.*In re* CM Holdings, Inc., 301 F.3d 96 (3d Cir. 2002).

xcix.Winn-Dixie Stores, Inc. v. Comm'r, 254 F.3d 1313 (11th Cir. 2001), *cert. denied*, 122 S. Ct. 1537 (2002).

c.Am. Elec. Power, Inc. v. United States, 136 F. Supp. 2d 762 (S.D. Ohio 2001), *aff'd*, 326 F.3d 737 (2003)..

ci.I.R.S. Announcement 2002-96, 2002-43 I.R.B. 756.

cii.*Id.*

ciii.David M. Katz, *The COLI Wars*, CFO MAGAZINE, Jan.1, 2001, at 87, *available at* cfo.com; *see also* Mark P. Gergen, *The Logic of Deterrence: Corporate Tax Shelters*, 55 TAX L. REV. 255, 256 (2002).

civ.*Government Wins Tax-Shelter Victory in Winn-Dixie Case*, WALL ST. J., June 29, 2001, at B3.

cv.Ellen E. Schultz & Theo Francis, *Valued Employees: Worker Dies, Firm Profits – Why?*, WALL ST. J., Apr. 19, 2002, at A1.

cvi.*Id.*

cvii.*Id.*

cviii.White Paper, American Bankers Association, Bank Owned Life Insurance, May 25, 2001, *available at* www.aba.com/NR/rdonlyres/00005350pkzlobiatfnisfsv/COLI+white+paper+draft+5-21b93.pdf-

cix.*Id.*

cx.*Id.*

cxi.*Id.*

cxii.*Id.*

cxiii.*Id.*

cxiv.Dow Chem. Co. v. United States, No. 00-10331-BC, 2003 WL 1701524, at *75-76 (E.D. Mich. Mar. 31, 2003).

cxv.*Id.* at *1.

cxvi.*Id.*

cxvii.*Id.* at *11.

cxviii.*Id.*

cxix.*Id.* at *13.

cxx.*Id.*

cxxi.*Id.* at *14.

cxxii.MICH. COMP. LAWS § 500.2210 (1991).

cxxiii.*Dow Chem. Co*., 2003 WL 1701524, at *33.

cxxiv.*Id.* at *44.

cxxv.Knetsch v. United States, 364 U.S. 361, 365-66 (1960); ACM P'ship v. Comm'r, 157 F.3d 231, 247 (3d Cir. 1998); *see also* Gregory v. Helvering, 293 U.S. 465, 469 (1935) (discussing sham transaction doctrine).

cxxvi.*Dow Chem. Co*., 2003 WL 1701524, at *49.

cxxvii.*Id.* at *56.

cxxviii.*Id.*

cxxix.*Id.*

cxxx.Theo Francis, *Proposal Aims to Cut Tax Breaks in Corporate-Owned Life Policies*, WALL ST. J., Mar. 12, 2003, at C9.

cxxxi.*Id.*

cxxxii.Schultz & Francis, *supra* note 101.

cxxxiii.L.M. Sixel, *Profiting from Death?*, HOUSTON CHRON., Apr. 16, 2002, at 1.

cxxxiv.Press Release, Congressman Gene Green, Congressman Gene Green Calls for Hearing on Corporate-Owned Life Insurance (Oct. 1, 2002), *available at* www.house.gov/green/nr100102.htm

cxxxv.Schultz & Francis, *supra* note 101.

cxxxvi.*Id.*

cxxxvii.Sixel, *supra* note 133.

cxxxviii.*Id.*

cxxxix.Ellen E. Schultz & Theo Francis, *Valued Employees: Worker Dies, Firm Profits – Why?*, WALL ST. J., Apr. 19, 2002, at A1.

cxl.*Id.* The same premium buys more coverage for younger workers because they are less likely to die soon. *Id.*

cxli.*Id.*

cxlii.*Id.*

cxliii.*Id.*

cxliv.L.L. Sixel, *Enron Utility's 'Dead Peasant' Policies Rankle*, HOUSTON CHRON., Apr. 24, 2002, at 1.

cxlv.*Id.*

cxlvi.*Id.*

cxlvii.Theo Francis, *Workers' Lives: Best Tax Break?*, WALL ST. J., Feb. 19, 2003, at C1, C9.

cxlviii.*Id.* Wachovia has about $6.1 billion in COLI policies. Theo Francis, *Workers'Lives: Best Tax Break?*, WALL ST. J., Feb. 19, 2003, at C1.

cxlix.Theo Francis & Ellen E. Schultz, *Big Banks Quietly Pile Up 'Janitors' Insurance*, WALL ST. J., May 2, 2002, at C1.

cl.*Big Business: Cashing in When You Cash Out*, CERT TIMES: FIN. ED., May 2, 2002, *available at* www.certtimes.com/fin//article.php?sid=45.

cli.*Id.*

clii.Theo Francis & Ellen E. Schultz, *Big Banks Quietly Pile Up 'Janitors' Insurance*, WALL ST. J., May 2, 2002, at C1.

cliii.*Id.*

cliv.12 U.S.C. § 24(seventh) (2002).

clv.Activities and Investments of Insured State Banks, 61 Fed. Reg. 43,486 (1996) (proposed rule for F.D.I.C. to amend 12 C.F.R. pt. 362).

clvi.OFFICE OF THE CONTROLLER OF THE CURRENCY, BANKING CIRCULAR 249 (May 9, 1991).

clvii.Activities and Investments of Insured State Banks, 61 Fed. Reg. 43,486 (1996) (proposed rule for F.D.I.C. to amend 12 C.F.R. pt. 36).

clviii.Guidelines for National Banks, 1996 OCC CB Lexis 92 (1996).

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clx.Guidelines for National Banks, 1996 OCC CB Lexis 92 (1996).

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clxii.*Id.*

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clxiv.Theo Francis & Ellen E. Schultz, *Why Secret Insurance on Employees Pays Off*, WALL ST. J., Apr. 25, 2002, at C1.

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clxvii.Bancorp Serv. v. Hartford Life Ins. Co., No. 4:00-cv-70 CEJ (E.D. Mo. decided Mar. 15, 2002), *summarized at* www.verdictsearch.com/news/verdicts/cases/topten_bancorp.jsk; *see also Fight over New Idea Leads to $118 Million Award*, NAT'L L.J., Feb. 3, 2003.

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clxxvi.Theo Francis & Ellen E. Schultz, *Insurers Move to Protect Executive Policy*, WALL ST. J., Dec. 30, 2002, at C1.

clxxvii.Ellen E. Schultz & Theo Francis, *Accounting for Enron: Enron Pensions Had More Room at the Top*, WALL ST. J., Jan. 23, 2002, at A4.

clxxviii.Joann S. Lublin, *Under the Radar*, WALL ST. J., Apr. 11, 2002, at B7.

clxxix.Theo Francis, *Snow's Latest Contract Covered Exit to Washington,* WALL ST. J., Dec. 10, 2002, at A10.

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clxxxiv.Ellen E. Schultz & Theo Francis, *Questioning the Books: Retirement Rules Won't Affect Appointees*, WALL ST. J., Feb. 13, 2002, at A12.

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clxxxviii. Monica Langley, *Effort to Limit Popular Tax Break Gains Momentum*, WALL ST. J., May 5, 2000, at B8.

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cxciii.*See* Andrew J. Willms, *Split-Dollar Insurance: New Rulings, New Regulations (and Sarbanes-Oxley?)*, 17 No. 2 PRAC. TAX LAW. 23, 26 (2003).

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cxcv.*Willms*, *supra* note 193, at 26.

cxcvi.*Corporate Law Firms Explore Gray Areas of New Ban on Loans*, WALL ST. J., Oct. 16, 2002, at C15.

cxcvii.Jennifer Schuessler, *Office Indemnity: Does Your Employer Want You Dead?* BOSTON GLOBE, Mar. 9, 2003, at D3.

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