IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

PAUL M. PRUSKY, et al.	:	CIVIL ACTION
	:	
v.	:	
	:	
RELIASTAR LIFE INSURANCE COMPANY	:	No. 03-6196

MEMORANDUM AND ORDER

HUTTON, S.J. December 7, 2004

Presently before this Court are Plaintiffs' Motion for Partial Summary Judgment (Docket No. 10), Defendant's Opposition thereto and Supporting Exhibits (Docket Nos. 16 & 17), Plaintiffs' Reply in Support of Plaintiffs' Motion for Summary Judgment (Docket No. 19), and Plaintiffs' Supplemental Memorandum in Support of Plaintiffs' Motion for Summary Judgment (Docket No. 32).

I. BACKGROUND

The Court has alluded to the following facts, in part, in previous Orders. Plaintiffs, Paul M. Prusky, individually and as trustee of the Windsor Securities, Inc. Profit Sharing Plan (the "Plan"), and his son Steven G. Prusky, also as a trustee, filed this diversity suit alleging that the Defendant, Reliastar Life Insurance Company ("Reliastar") breached seven separate life insurance contracts (collectively "the Contracts") by terminating Plaintiff's ability to execute trades by telephone, fax, or other

electronic means as often as once per day.[1] Plaintiffs assert that by restricting trading in this manner, Reliastar prohibited Plaintiffs from carrying out their preferred investment strategy, commonly referred to as "market timing."[2]

Plaintiffs, as trustees of the Plan, purchased the Contracts at issue in this case between February and August of 1998. With the exception of the various face values of the Contracts (they ranged from $2,000,000 to $10,000,000) the Contracts are substantially the same. The Plan owns and is the beneficiary under the Contracts while Paul Prusky, and his wife Susan, are the joint insureds.

The Contracts are flexible premium variable life insurance policies. These policies specify that portions of the premiums paid by the Plan are to be held in a "Variable Account" owned by Reliastar. Reliastar uses the Variable Account to receive and invest premiums paid by Reliastar policy holders. The Variable Account is divided into several sub-accounts. Plaintiffs have the ability to choose among a variety of mutual funds and inform Reliastar how they want their premiums, held in each sub-account,

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[1] Plaintiffs also asserted that Reliastar violated Pennsylvania's Unfair Trade and Consumer Protection Law, Pa. Stat. Ann. tit. 73, § 201-1 et seq. (West 2003). This claim, however, was dismissed in a joint stipulation filed on November 12, 2004. See Docket No. 36.

[2] Market timing is a practice whereby mutual fund traders seek short-term profits by frequently trading mutual fund shares in anticipation of changes in market prices. Mandatory Redemption Fees for Redeemable Fund Securities, SEC Rel. No. 1C-2637A, 69 FR 11762, 11762 (March 11, 2004); see also Windsor Sec., Inc. v. Hartford Life Ins. Co., 986 F.2d 655, 657 n.1 (3d Cir. 1993) ("market timing is the movement of funds from capital to money markets (or vice-versa) based on the market timer's evaluation of short-term market conditions").

to be invested.

Pursuant to the Contracts, Plaintiffs also had the ability to transfer funds among the sub-accounts, and therefore among different mutual funds, as long as the request was made in writing. Pl.'s Compl. Ex. B at 14. The Contracts explicitly stated that Reliastar would only allow four transfers per year. Id. However, each contract also allowed for changes to be made to the policy so long as the changes were made in writing and signed by an authorized Reliastar representative.

A separate memorandum from M.C. Peg Sierk, Second Vice President of Reliastar (the "Sierk Memos") amended each of the Contracts. The Sierk Memos explicitly provided that they were "an integral part of" each of the Contracts and they would remain so throughout the life of the policies. They also stated the following, in pertinent part:

> Transfers by the holder of [the policy] among all sub-accounts available to any Reliastar Life Insurance Company (RLIC) policyholder of the same policy type, may take place as often as once per day. Transfer requests may be made in writing to the home office of RLIC or, at the policyholder's choice, via telephone, fax or other electronic substitute in accordance with a properly executed Telephone Transfer Authorization Form (TTA), that has been received and recorded by RLIC. Any transfer requests received at the home office of RLIC up until 4:00 Central Standard Time on any day the New York Stock Exchange (NYSE) is open will receive unit values of the same day as the request is received.
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> ***
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> RLIC will accept and effectuate all transfers to and from all sub-accounts available to any other policyholder

(without limitation, except as noted herein), with no restriction as to the dollar amount of the transfer.

The only other language in the Sierk Memos that allows Reliastar to limit Plaintiffs' ability to transfer its premiums among mutual funds is a provision stating that Plaintiffs could only transfer among the seventeen sub-accounts specified by the policy until Reliastar's system could handle an increase in investment options in the future. See Pl.'s Compl. Ex. C.

On March 6, 1998, Plaintiffs began submitting requests for sub-account transfers to Reliastar. Plaintiffs frequently made transfer requests by fax or telephone and sometimes made these requests as often as once per day. Plaintiffs also submitted requests up until 4:00 Central Standard Time and received that day's pricing. Reliastar accepted and processed these requests for approximately five and one-half years.

This practice ended on October 8, 2003, when Reliastar's Director of Life Policy Owner Services Christie M. Gutknecht notified Plaintiffs in writing that Reliastar would no longer allow Plaintiffs to submit sub-account transfers by telephone, fax, or any other electronic means (the "Gutknecht Memo").[3] See Def.'s Reply Ex. 8. Reliastar required Plaintiffs to submit their requests by mail to Reliastar's customer service center in Minot, North

[3] By this time the ultimate parent of ING North America Insurance Corp. acquired Reliastar. For the purposes of this Memorandum the Court will continue to refer to Defendant as Reliastar and not ING.

Dakota.[4] The Gutknecht Memo stated that Reliastar was imposing these restrictions because Plaintiffs were "recently identified as participating in excessive fund timing activities." Id. The Gutknecht Memo also stated that Reliastar derived its authority to impose this restriction from Plaintiffs' policy prospectus that contained an "excessive trading policy" and further stated that this restriction would allow its portfolio managers to "be able to perform better over the long term for all policy owners without increased trading and transaction costs, forced and unplanned portfolio turnover, lost opportunity costs, and large asset swings that decrease the Fund's ability to provide maximum investment return." Id. Plaintiffs filed this suit on November 12, 2003, after Reliastar refused to lift the restrictions set forth in the Gutknecht Memo.

Plaintiffs seek an injunction ordering Reliastar to accept Plaintiffs' transfer requests by telephone, fax, or other electronic means as often as once per day, as specified in the Sierk Memos. Plaintiffs' are not, however, asking this Court to order that Reliastar accept their transfer requests up until 4:00 Central Standard Time, which is also provided for in the Sierk

[4] The restrictions had the additional effect, for all practical purposes, of stripping from the Contracts any benefit Plaintiffs might have received from the provision allowing Plaintiffs to submit transfer requests up until 4:00 Central Standard Time. By forcing Plaintiffs to submit requests by mail there was no way for Plaintiffs to receive same-day pricing given the time lapse between the time a request could be mailed by Plaintiffs from Pennsylvania and received by Reliastar in North Dakota.

Memos and is similarly being prohibited by Reliastar. Contending that the “4:00 Central Standard Time” provision is illegal under federal law, and that an illegal provision of a contract voids the entire agreement between the parties, Reliastar asks this Court to deny Plaintiff’s Motion for Partial Summary Judgment.

II. LEGAL STANDARDS

A. Summary Judgment

Rule 56(c) states that summary judgment is appropriate "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). A court must determine "whether the evidence presents a sufficient [factual] disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 251-52 (1986).

When considering a motion for summary judgment, a court must view all facts and inferences in a light most favorable to the nonmoving party. See Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587 (1986). The court's "function is not to weigh the evidence and determine the truth of the matter," but to determine whether there are genuine issues of material fact in dispute. Carter v. Exxon Co., 177 F.3d 197, 202 (3d Cir. 1999)

(citation omitted). Once the moving party has met the initial burden of demonstrating the absence of a genuine issue of material fact, the non-moving party must establish the existence of each element of its case. J.F. Feeser, Inc. v. Serv-A-Portion, Inc., 909 F.2d 1524, 1531 (3d Cir. 1990) (citing Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986)). Nonetheless, a party opposing summary judgment must do more than just rest upon mere allegations, general denials, or vague statements. See Trap Rock Indus., Inc. v. Local 825, 982 F.2d 884, 890 (3d Cir. 1992).

District courts are widely acknowledged to possess the power to enter summary judgment sua sponte, so long as the losing parties were on notice that they had to come forward with all of their evidence. See Celotex Corp. v. Catrett, 477 U.S. 317, 326 (1986); Helmrich Transp. Systems, Inc. v. City of Philadelphia, 2004 WL 2278534, at *6 (E.D. Pa. Oct. 8, 2004). District courts also have the authority to grant summary judgment in favor of the non-moving party in cases where the moving party has had adequate notice of the grounds for the judgment and where there is clear support for the judgment. See Banks v. Lackawanna County Comm'rs, 931 F. Supp. 359, 363 n. 7 (M.D. Pa. 1996); see also DeFelice v. Philadelphia Bd. of Ed., 306 F. Supp. 1345, 1348 (E.D. Pa. 1969). The fact that the non-movant has not filed a cross-motion for summary judgment does not, therefore, preclude the Court from entering judgment in the non-movant's favor. See 10A Charles A. Wright, et al., Federal

Practice and Procedure, § 2720 at 347 (3d ed. 1998) ([t]he weight of authority, however, is that summary judgment may be rendered in favor of the opposing party even though the opponent has made no formal cross-motion under Rule 56").

B. Illegal Contracts[5]

It is well-established that if a contract is for an illegal purpose, "the court may not lend its aid to enforce it, and it must leave the parties where it finds them." See Bauman and Vogel, C.P.A. v. Del Vecchio, 423 F. Supp. 1041 (E.D. Pa. 1976). As a general rule, an agreement which violates a statutory provision, "or which cannot be effectively performed without violating [a] statute, is illegal, unenforceable, and void ab initio." Gramby v. Cobb, 422 A.2d 889, 892 (Pa. Super. 1980).

A slight variation exists in cases where a contract contains both legal and illegal provisions – a situation often referred to as partial illegality. The Pennsylvania Supreme Court, quoting the Restatement (First) of Contracts, has stated the rule in these cases as follows:

> 'Where any part of a bilateral bargain is illegal, no promise can be enforced unless not only that promise is legal but a corresponding legal promise is, by the terms of the bargain, apportioned as consideration therefor, nor even in that case if the illegal portion of bargain is an essential part of it.' . . . Or, as stated in Comment a to the above-cited section of the Restatement, 'If . . . a promise is made by A to do something lawful while B promises to do two things, one lawful and one

[5] Since this is a diversity suit, the Court applies Pennsylvania law.

unlawful, there can be no recovery on either side.

Deibler v. Chas. H. Elliot Co., 81 A.2d 557, 561 (Pa. 1951) (quoting Restatement (First) of Contracts § 67 & cmt. a). See also Davis v. Pennzoil Co., 264 A.2d 597, 605 (Pa. 1970) ("as a matter of state law, this Court will not enforce an illegal transaction . . . and this is particularly so when the illegality involves the violation of a federal statute") (citations omitted); Dalton, Dalton, Little, Inc. v. Mirandi, 412 F. Supp. 1001, 1003 (D. N.J. 1976) ("the question has sometimes turned on whether the illegal provision, by the terms of the bargain, has a specific consideration apportioned to it; but even in such cases the contractual apportionment will not save the agreement if the illegal portion is an essential part of the contract as a whole") (citations omitted).

III. DISCUSSION

Plaintiffs assert that there is no genuine issue of material fact as to Reliastar's liability for breach of contract and their request for specific performance. Plaintiffs contend that the Contracts and the Sierk Memos, taken together, explicitly allow daily fax and telephone transfer requests. Furthermore, Plaintiffs argue, Reliastar's course of performance over five and one-half years ratifies and confirms that Reliastar was contractually bound to accept fax and telephone transfer requests from Plaintiffs. Finally, Plaintiffs maintain that Reliastar's restriction allowing

communications solely by regular U.S. mail forecloses Plaintiff's desired investment strategy and imposes a continuous financial harm justifying that this Court order Reliastar to lift its restriction.

Reliastar does not argue that imposing its restriction is within the company's rights under the terms of the Contracts. Instead, Reliastar claims that Plaintiff's summary judgment motion should be denied because its performance under the Contracts is excused under a variety of separate theories. The first theory, and the theory this Court will discuss at length below, is that the Contracts are illegal and therefore void. Reliastar argues that because the Sierk Memos allowed Plaintiffs to submit transfer requests "up until 4:00 Central Standard Time," the Contracts are illegal under federal law. This provision, allowing a practice commonly referred to as "late trading," gave Plaintiffs the ability to submit trades for one hour after the close of the NYSE at 4:00 Eastern Standard Time and receive same day pricing.

The Contracts at issue in this case are partially illegal because they contain both legal and illegal provisions: while market timing is not per se illegal, late trading is, and both practices are allowed under the explicit terms of the Sierk Memos. Rule 22c-1 of the Investment Company Act, 15 U.S.C. § 80a et seq., requires all registered investment companies to sell and redeem mutual fund shares at a price based on the current net asset value ("NAV") "next computed after receipt of a tender of such security

for redemption or of an order to purchase or sell such security." 17 C.F.R. § 270.22c-1. Noting that most funds calculate NAV when the major U.S. stock exchanges close at 4:00 Eastern Time, the SEC has explained the operation of this Rule in the context of late trading provisions:

> Under Rule 22c-1, an investor who submits an order before the 4:00 p.m. pricing time must receive that day's price, and an investor who submits an order after the pricing time must receive the next day's price. "Late trading" refers to the illegal practice of permitting a purchase or redemption order received after the 4:00 p.m. pricing time to receive the share price calculated as of 4:00 p.m. that day. A late trader can exploit events occurring after 4:00 p.m., such as earnings announcements, by buying on good news (and thus obtaining fund shares too cheaply) or selling on bad news (and thus selling at a higher price than the shares are worth). In either case, the late trader profits at the expense of long-term investors in the fund.

Amendments to Rules Governing Pricing of Mutual Fund Shares, SEC Rel. No. 1C-26288, 68 F.R. 70388 (Dec. 11, 2003).

Based on the Record before the Court there is no question of material fact as to whether the Sierk Memos allowed Plaintiffs to engage in the illegal practice of late trading. The Sierk Memos stated, "[a]ny transfer requests received at the home office of RLIC up until 4:00 Central Standard Time on any day the New York Stock Exchange (NYSE) is open will receive unit values of the same day as the request is received." Pl.'s Compl. Ex. C (emphasis added). This allowed Plaintiffs one hour between the close of the NYSE at 4:00 Eastern Time and 4:00 Central Time to submit transfer requests to Reliastar, via fax or telephone, to exploit the

significant advantages of late trading briefly mentioned above.

The illegal late trading provision in the Contracts renders the entirety of the Contracts void. The bilateral contracts between Plaintiffs and Reliastar can be summarized as follows: Plaintiffs paid premiums and fees to Reliastar in exchange for Reliastar providing (1) life insurance coverage on the lives of Paul and Susan Prusky, (2) the ability to engage in late trading, and (3) the ability to engage in market timing. Plaintiffs' consideration in the form of premiums and fees was not apportioned among the three services Reliastar provided under the Contracts. In other words, Plaintiffs paid for, among other things, an illegal service in a lump sum payment; Reliastar provided the illegal service in return. Although Plaintiffs ask this Court to enforce only the market timing provision of the Contracts, Plaintiffs' consideration was not apportioned between legal and illegal promises; therefore, the presence of the late trading provision in the Contracts renders all of the Contracts void.

In their Reply Memorandum of Law in Support of Plaintiffs' Summary Judgment Motion Plaintiffs respond to Reliastar's argument that the Contracts are void in their entirety. Plaintiffs cite a series of Pennsylvania cases in which the courts, sitting in equity, when asked to enforce partially illegal contracts, severed the illegal portions and enforced the legal portions of the contracts. See Pl.'s Reply Memo. at 6-9. The holdings from these

cases, however, are inapplicable to the Contracts at issue in this case and have a more narrow application than Plaintiffs suggest. Set forth in the Restatement under the heading "Divisible Promises in Restraint of Trade," the rule to which Plaintiffs refer is as follows:

> Where a promise in reasonable restraint of trade in a bargain has added to it a promise in unreasonable restraint, the former promise is enforceable unless the entire agreement is part of a plan to obtain a monopoly; but if full performance of a promise indivisible in terms, would involve unreasonable restraint, the promise is illegal and is not enforceable even for so much of the performance as would be a reasonable restraint.

Restatement (First) of Contracts § 518. The rule applies to situations where a court is asked to enforce a restrictive covenant containing a provision that is illegal as an unreasonable restraint. In these cases the court will enforce the reasonable portion of the covenant and strike the unreasonable portion. See, e.g., Alexander & Alexander, Inc. v. Drayton, 378 F. Supp. 824, 830 (E.D. Pa. 1974) (modifying contracts held to be unreasonable restraints by reducing time limitation from 10 to 2 years and by reducing the geographic scope limitation from a 100 mile radius around New York, Boston, and Philadelphia to a 100 mile radius around Philadelphia) (citations omitted).

The Contracts at issue in this case are not restrictive covenants. They are bilateral agreements between Plaintiffs and Reliastar in which Plaintiffs agreed to pay a sum of money and in return, in part, Plaintiffs were given the ability to engage in

financial activities, one of which is illegal under federal law. Under the law of Pennsylvania, the Court cannot sever the illegal late trading provision and enforce the market timing provision in the Contracts as Plaintiffs request. To do so would be to sanction Plaintiffs' purchase of a service that violates the Federal Securities laws; the Court has no means by which to separate the portion of Plaintiffs' payments going towards legal market timing and the portion going towards illegal late trading. Since the Contracts contain an illegal provision for which Plaintiffs did not pay separate consideration, the entirety of the Contracts are void and unenforceable.[6]

This Court has the power to grant summary judgment to the non-moving party in cases where the judgment is supported by the record and the moving party has notice. Based on the Record before the Court and the fact that Plaintiffs have had ample notice to produce evidence to support their claims, the Court will exercise its power in this case. Plaintiffs have submitted arguments and supporting evidence in response to Reliastar's illegality defense for this

[6] Plaintiffs have submitted to the Court a reference to the recent decision Prusky, et al. v. Aetna Life Ins. and Annuity Co., et al., 2004 U.S. Dist. LEXIS 21597 (E.D. Pa. October 25, 2004) (Bartle, J.), in which the court granted summary judgment in favor of Plaintiffs and ordered that the insurance companies continue to allow Plaintiffs to engage in the contracted-for practice of market timing. Although this Court agrees with Plaintiffs' reading of Aetna to the extent that the Court dismissed many of the same arguments Reliastar has asserted in this case, there is one crucial difference that leads this Court to reach a different result. The contracts at issue in Aetna did not allow for late trading; the Contracts at issue here explicitly allow late trading. This difference, under Pennsylvania law, means that while the contracts in Aetna are legal and enforceable, the Contracts at issue in this case are illegal and unenforceable and therefore the Court cannot order Reliastar to perform pursuant to the terms of the Contracts.

Court to review. The parties jointly dismissed Count II of Plaintiffs' Complaint earlier, and therefore Plaintiffs' only remaining claim is a claim for breach of contract. As explained above, the presence of the late trading provision in the Contracts renders all of the Contracts void. "Where there is turpitude, the law will help neither party." Trist v. Child, 88 U.S. 441, 452 (1874). Therefore the Court grants summary judgment in favor of Reliastar on Plaintiffs' breach of contract claim.

An appropriate Order follows.

IN THE UNITED STATES DISTRICT COURT
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PAUL M. PRUSKY, et al.	:	CIVIL ACTION
v.	:	
RELIASTAR LIFE INSURANCE COMPANY	:	No. 03-6196

O R D E R

AND NOW, this 7th day of December, 2004, upon consideration of Plaintiffs' Motion for Partial Summary Judgment (Docket No. 10), Defendant's Opposition thereto and Supporting Exhibits (Docket Nos. 16 & 17), Plaintiffs' Reply in Support of Plaintiffs' Motion for Summary Judgment (Docket No. 19), and Plaintiffs' Supplemental Memorandum in Support of Plaintiffs' Motion for Summary Judgment (Docket No. 32), IT IS HEREBY ORDERED that:

(1) Plaintiffs' Motion for Partial Summary Judgment is **DENIED;** and

(2) Summary judgment in favor of Defendant on Plaintiffs' claim for breach of contract is **GRANTED**.

IT IS FURTHER ORDERED that the Plaintiffs' Complaint is DISMISSED with prejudice and the Clerk of the Court shall mark this case closed.

BY THE COURT:

S/
HERBERT J. HUTTON, S.J.