Case No. 15-55809

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

JOYCE WALKER, KIM BRUCE HOWLETT, AND MURIEL SPOONER,
ON BEHALF OF THEMSELVES AND ALL OTHERS SIMILARLY SITUATED

Plaintiffs-Appellants,

LIFE INSURANCE COMPANY OF THE SOUTHWEST,

Defendant-Appellee,

From a Judgment Entered on May 4, 2015
By the United States District Court for the Central District of California
No. 10-cv-09198-JVS(RNBx)
Before The Honorable James Selna

REPLY BRIEF

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I. Introduction

LSW seeks *de facto* immunity for wrongdoing that harms the retirement security of thousands of class members. This Court should not grant it.

LSW seeks immunity for its indisputable violations of Insurance Code Section 10509.950, *et seq*., ("Illustration Statute") by arguing that injured private parties have no cause of action under the UCL. But UCL claims are available unless the underlying statute or another principle of law affirmatively bars a UCL action. Neither does here. Moreover, the well-reasoned amicus brief of California's Attorney General and Insurance Commissioner makes clear that private enforcement of the Illustration Statute is necessary to protect consumers.

LSW seeks immunity for its bait and switch scheme by arguing that Proposition 64 overruled *Chern v. Bank of America*, 15 Cal. 3d 866 (1976) and eliminated the UCL's prohibition on bait and switch schemes, allowing consumers to be misled by LSW's illustrations stating, in bold print, that there is only "***One Policy Fee***," when in fact there are numerous fees that collectively siphon massive amounts of money out of the policies. LSW is wrong because Proposition 64 did not change the substantive scope of the UCL, and its reliance requirement requires only that the deception be a substantial factor in influencing the purchase decision, a test easily met by bait and switch schemes like that here.

LSW never denies that S&P 500 volatility imposes risks that are not captured in the numerical descriptions of policy performance that are the centerpiece of the illustrations. Instead, LSW claims, and the court found, that LSW's narrative statements about the numerical projections adequately disclose volatility risks. But risks from S&P volatility itself – not just the risk that the average level of S&P performance may differ from the past -- are not disclosed. The court's contrary ruling is reversible either as a matter of law or as clearly erroneous, and the other findings on volatility are either incorrect or avoid addressing Plaintiffs' claim.

II. Plaintiffs' UCL Claims Predicated on the Illustration Statute

Section 17205 makes clear that "[u]nless otherwise expressly provided," the UCL's remedies "are cumulative . . . to the remedies and penalties available under all other laws." UCL claims are available unless the predicate statute "*expressly*" provides otherwise or the UCL claim is "absolutely barred under some other principle of law." *Stop Youth Addiction v. Lucky Stores*, 17 Cal. 4th 553, 566 & 573 (1998); *State of California v. Altus Finance, S.A.*, 36 Cal. 4th 1284 (2005); *Chabner v. United of Omaha Life Ins. Co.*, 225 F.3d 1042, 1049 (9th Cir. 2000) (permitting UCL claim predicated on Insurance Code because no statute permitted challenged conduct and "nothing specifically bars this cause of action.").

LSW concedes the Illustration Statute does not affirmatively bar a UCL action and fails to identify any principle of law that would bar it.

A. *Moradi-Shalal* Is Inapplicable

Moradi-Shalal v. Fireman's Fund Ins. Co., 46 Cal. 3d 287 (1988) and its progeny (*Safeco Ins. Co. v. Superior Court*, 216 Cal. App. 3d 1491, 1494 (1990)) hold that a UCL claim cannot be predicated on a violation of the UIPA for two reasons, neither of which is present here. One is a principle of law based on public policy, specifically a desire to eliminate "the undesirable social and economic effects of the [*Royal-Globe*] decision (i.e., multiple litigation, unwarranted bad faith claims, coercive settlements, excessive jury awards, and escalating insurance, legal and other 'transaction' costs)." *Moradi-Shalal*, 46 Cal.3d at 299 & 301-03; *Stop Youth Addiction*, 17 Cal. 4th at 561-63 & 565-66.

The second reason is legislative intent expressed in the UIPA that is inconsistent with non-administrative enforcement, specifically Section 790.03(h)'s requirement of a pattern of misconduct. *Moradi-Shalal*, 46 Cal.3d at 294-95 & 303.

None of the considerations underlying the rule of *Moradi-Shalal* are present here, and LSW has identified no other principle of law barring UCL claims predicated on the Illustration Statute.[1] To the contrary, the Attorney General and Insurance Commissioner explain that finite resources and limited administrative remedies mean that "public policy strongly supports preserving private parties' ability to bring UCL actions against their insurers for violations of the illustration statutes." Amicus 4 & 27-28.

B. The Legislative History of the Illustration Statute

Although the Illustration Statute's legislative history cannot by itself bar a UCL claim, that legislative history does not suggest such an intent.

LSW does not contend that the Legislature considered the UCL in enacting the Illustration Statute. LSW53. Thus, the Legislature could not have affirmatively intended to preclude UCL actions because it has been aware since 1983 that UCL actions are permitted even if the predicate statute provides no private cause of action. *Stop Youth Addiction*, 17 Cal. 4th at 562-63.

The drafters of the NAIC model regulation on which the Illustration Statute is based did not include a private cause of action due to "NAIC policy," but this is not surprising because the NAIC was drafting standards for 50 states with differing enforcement regimes. LSW55. States with statutes like the UCL would not need a

[1] The court barred both Plaintiffs' unlawfulness and unfairness claims predicated on the Illustration Statute, which resulted in the counter-factual holding that Plaintiffs' remaining unfairness claims failed because they were not "tethered to a legislatively declared policy." ER791 70. Although Plaintiffs pointed out this clear error, Op.30, LSW makes no effort to explain, let alone defend, the unfairness ruling.

private cause of action, and other states without such a law may not want private party enforcement. Indeed, the NAIC drafters believed no private cause of action was needed because "the remedy provided under the private cause of action already existed."[2] LSW App. A 12-13.

In any event, as *Rose v. Bank of America, N.A.*, 57 Cal. 4th 390, 397 (2013), makes clear, even the NAIC's affirmative act of deleting a private cause of action is insufficient to foreclose UCL liability.

C. The Debate Between The *Zhang* Majority And Concurring Opinions Is Irrelevant

LSW argues Plaintiffs' position "parallels" the concurrence in *Zhang*, which contended that *Moradi-Shalal* precluded only UIPA-based claims for damages, not claims for restitution. *Zhang v. Superior Court*, 57 Cal. 4th 364, 388-89 (2013). The majority rejected this position, stating "[w]hen the Legislature enacted the UIPA, it contemplated only administrative enforcement by the Insurance Commissioner," and that "private UIPA actions are absolutely barred." *Id*. at 384.

[2] LSW's reliance on the use of the word "penalties" in Section 10509.961 is misplaced. The drafters' use of the words "remedies" and "remedy" (LSW App. A 12-13) suggests that the word "penalties" had a generic meaning and was not intended to exclude restitution. *Clark v. Superior Court*, 50 Cal. 4th 605, 609 (2010), held 14 years later that the word "penalty" in Civil Code Section 3345 does not include UCL restitution, but that cannot change the drafters' intent. Further, Section 10509.961 falls far short of an ***express*** statement negating UCL claims, as is required.

This debate is irrelevant here because even the majority relied on legislative intent expressed in the UIPA's requirement that the defendant perform the prohibited claims handling practices "with such frequency as to indicate a general business practice." Ins. Code Section 790.03(h). The *Zhang* majority viewed *Moradi-Shalal* as adopting Justice Richardson's dissent in *Royal Globe*, "holding that the UIPA contemplates only administrative sanctions for practices *amounting to a pattern of misconduct*." *Zhang*, 57 Cal. 4th at 380 n.8 (emphasis added). The pattern of misconduct requirement was central to Justice Richardson's conclusion that only administrative enforcement was permissible since a single plaintiff's case could never satisfy the pattern requirement. *Royal Globe Ins. Co. v. Superior Court*, 23 Cal. 3d 880, 893-897 (1979).[3] The Illustration Statute has no pattern of misconduct requirement; nor is it subject to the public policy considerations of *Moradi-Shalal* (the absence of which would be a sufficient basis for the concurring justices to permit a private UCL action).

The debate also is irrelevant because it is dictum (both majority and concurring opinions ruled for plaintiff, who did not plead a UCL claim based on the UIPA). The majority's dictum is also ambiguous and should not be read to conflict with Section 17205, yet that is what LSW urges in reading the dictum to

[3] Justice Richardson also found it "highly significant" that the Insurance Commissioner had submitted an *amicus* brief arguing against a private cause of action under the UIPA. Here, the Commissioner favors permitting Plaintiffs' UCL claim.

mean that a UCL claim may not be predicated on a statute as to which the Legislature contemplated only administrative enforcement, even though that intent is not expressed in the statute and public policy concerns do not otherwise bar the UCL action.

D. LSW's Other Authorities Do Not Support Its Position

LSW asserts, "when the Legislature enacts [] a comprehensive regulatory scheme, it normally intends to bar UCL actions." But there is no such rule, and the cases LSW cites do not support one. *Loeffler v. Target Corp*., 58 Cal. 4th 1081, 1125-32 (2014) (safe harbor in Revenue and Taxation Code); *Vacanti v. State Compensation Insurance Fund*, 24 Cal.4th 800, 827-28 (2001) (allowed some UCL claims and disallowed others given the *express* exclusivity provisions of Workers' Compensation statutes). *Summit Technology v. High-Line Medical Instruments*, 922 F. Supp. 299, 316 (C.D. Cal 1996) predated *Stop Youth Addiction* and *Chabner* and is bad law. *Rezner v. Bayerishe Hypo-Und Vereinsbank AG*, 2011 U.S. Dist. LEXIS 148592,*19-20 (N.D. Cal. 2011); *Ferrington v. McAfee, Inc*., 2010 U.S. Dist. LEXIS 106600,*43-44 (N.D. Cal. 2010).

LSW's discussion of *Hughes v. Progressive Direct Ins. Co*., 196 Cal. App. 4th 754, 770 (2011), review granted 261 P.3d 756 (2011), review dismissed, 307

P.3d 877 (2013), stands that decision on its head.[4] The amendment to Section 758.5 the Legislature rejected bears no resemblance to Section 10509.961. In *Hughes*, as here, there was no "express legislative direction" to preclude enforcement of the Insurance Code via the UCL. *Id*. at 770.

E. Dismissal Was Not Harmless Error

LSW asserts that dismissal of Plaintiffs' UCL claims based on the Illustration Statute was harmless error because Plaintiffs "pursue[d] the same theories," and the "subsequent findings would have defeated liability." LSW61-62. LSW is wrong. The dismissed claims alleged eleven violations of the Illustration Statute, many of which did not overlap with the theories that were tried. ER464-12 ¶¶95(c)-(n). For example, Plaintiffs alleged that the illustration violated Section 10509.956(e)(3), which permits non-guaranteed elements to be shown in the illustration only if they are "described in the contract," because the Account Value Enhancement, the reduced or eliminated Monthly Administrative Charge, and the elimination of the Percent of Accumulated Value Charge are not described in the contract. Plaintiffs were not permitted to pursue this theory and there were no findings affecting this patently valid claim.

[4] No rule prohibits citation of *Hughes* in federal proceedings for its persuasive value. *Smith v. Harrington*, 2015 U.S. Dist. LEXIS 39628, *63 n. 8 (N.D. Cal. 2015).

Concerning Plaintiffs' claim that LSW violated Section 10509.955(b)(6), which prohibits an insurer from providing "an applicant with an incomplete illustration" (ER464-13, ¶ 95(d)), by not disclosing the fees and true guarantee in the illustration, LSW argues that the court found LSW's depiction of "charges and guaranteed values" not misleading. But the court found that fees and guaranteed interest are adequately described in the *policy* – information in the *policy* cannot make the *illustration* "complete" under the Illustration Statute.

LSW is correct that the court found the illustration's depiction of the Monthly Administrative Charge was not misleading, but this finding is clearly erroneous, as no layperson could discern that the MAC reduction is not guaranteed. Indeed, the finding is purportedly based on "the illustrations' clear disclaimer . . . that the only items that are guaranteed are those clearly labeled as such," ER791 12-16, but the court, like LSW, got it backwards: Section 10509.956(a)(7) requires that any nonguaranteed elements "shall be clearly labeled nonguaranteed."[5]

III. Plaintiffs' Bait And Switch Claims

A. The Decision Contravened *Chern*

1. *Chern* Remains Good Law

LSW argues *Chern v. Bank of Am.*, 15 Cal. 3d 866 (1976) is a dead letter

[5] LSW argues that the court rejected Dr. Brockett's testimony, so Plaintiffs cannot establish damages. LSW 62-63. But his testimony was rejected only in regard to the volatility theory. Moreover, Plaintiffs' individual UCL claims sought restitution and injunctive relief – not damages.

because the voters purportedly legalized bait-and-switch schemes in adopting Proposition 64's injury in fact requirement on UCL claims. LSW39-40. LSW does not cite any case accepting this remarkable theory, nor did the court accept it.

LSW is wrong because in establishing reliance post-Proposition 64, "[i]t is not . . . necessary that [the plaintiff's] reliance upon the truth of the fraudulent misrepresentation be the sole or even the predominant or decisive factor in influencing his conduct . . . It is enough that the representation has played a substantial part, and so has been a substantial factor, in influencing his decision." *In re Tobacco II*, 46 Cal. 4th 298 at 326-27. In addition, "a presumption, or at least an inference, of reliance arises wherever there is a showing that a misrepresentation was material." *Id.*

Chern is consistent with this reliance requirement because it held, on a bait-and-switch claim, the required reliance is only that "the original [deception] may unfairly entice persons to commence [] negotiations with defendant in the expectation of obtaining that [originally represented product]." *Chern*, 15 Cal. 3d at 876. *Chern* recognizes the nature of bait and switch schemes is to saddle consumers with sunk costs. Sunk costs generate a "tendency to continue an endeavor once an investment in money, effort, or time has been made." Hal R. Arkes & Catherine Blumer, The Psychology of Sunk Cost, 35 *Org. Behav. & Hum. Decision Process* 124, 124–25 (1985). LSW induced Plaintiffs to continue the transaction here by providing them with deceptive illustrations, which led them to submit their applications and undergo their medical exams.[6] LSW provided corrective information in the policy at the time of sale, but only after Plaintiffs had made substantial investments of time and effort, and that information does not defeat Plaintiffs' showing that LSW's deceptive illustrations were a substantial factor in influencing their decision to make the transaction.

Post-Proposition 64, this Court has recognized, consistent with *Chern*, that truthful disclosures do not negate reliance on deceptive marketing materials. *Williams v. Gerber Prods. Co.*, 552 F.3d 934, 938 (9th Cir. 2008) held the defendant could not "mislead consumers" with fruit juice packaging and "then rely on the ingredient list to correct those misinterpretations and provide a shield for liability for the deception." *Id*. at 939-40. Even though the ingredient list fully disclosed the truth, this Court did not find that plaintiffs could not rely on the misrepresentation on the front of the packaging.[7]

LSW argues that *Chern* and *Williams* are distinguishable because they purportedly "addressed only what could go to trial," LSW40-41&n. 18, but the

[6] LSW asserts that Howlett and Spooner decided to "move forward" with their application without seeing an illustration, but they actually testified that they wanted to meet with their agent again to "move forward with finding out about the plan"; they did so by extensively reviewing the illustration, which led them to apply for and eventually purchase the policies. TX637; ER808 79-85.

[7] LSW cannot evade the law because the illustration referred to the policy for "complete details"; in *Williams*, complete details were presented elsewhere on the same package.

court's post-trial rationale – that later-delivered policy disclosures are a defense – is equally applicable pre-trial and at trial, and was specifically rejected in *Chern* and *Williams*.

Finally, LSW's interpretation of Proposition 64 should be rejected because Proposition 64 was narrowly designed to limit "shakedown lawsuits" and situations where private attorneys brought lawsuits on behalf of plaintiffs who never "had any business dealing with the defendant." Plaintiffs' Request for Judicial Notice at Ex. A (Prop. 64 § 1(b)(3)). LSW provides no basis to assume that the voters who adopted Proposition 64 intended to eliminate the prohibition on bait and switch schemes. Indeed, that cannot be true because Section 17500, to which Proposition 64 also applies, explicitly prohibits bait and switch schemes.

2. There Are No Alternate Grounds For Affirmance

LSW also argues the projected index crediting gains in the illustrated values are presented net of fees, so the illustration "could not mislead." LSW41-42. But embedding the fees with the projected market performance makes it impossible for consumers to know the amount of fees standing alone, or what the policy will cost if the market does not perform as projected. LSW's witness, Elizabeth MacGowan, admitted the illustrated values do not allow consumers to ascertain the fees. ER811 131:9-132:8; LSW36 n. 11.

LSW is wrong that Plaintiffs had no benchmark for the enormity of fees –

45.9% of total premiums paid by the class prior to trial was consumed by fees. ER775-1, Ex. A. Mr. Howlett's entire investment of $105,750 -- plus investment gains of $17,679 – were consumed by fees in only three years. ER806 49:20-52:19. It is no mystery why LSW conceals its fees by embedding them in illustrated values, separately disclosing only the MAC charge and stating there is only '***One Policy Fee***.' '***One Policy Fee***' is a baldfaced (indeed **boldfaced**) lie and a clear *Chern* violation. The court mentioned neither the '***One Policy Fee***' misrepresentation nor *Chern* in its decision, which amounts to a failure to rule on the claim and is reversible for that reason alone.

LSW also incorrectly asserts that Plaintiffs' guarantee claim failed because "the illustration stated that the yearly return on a guaranteed basis *could be zero*." LSW42. But the illustration states the "interest rate used in the calculation of guaranteed values is 2.50%." TX4 LSW00001997. An entirely different page states that the "Index Earnings" are "adjusted so that it is no less than 0%," TX4 LSW00001993, but the guarantee is a product feature independent from index earnings.

B. The MAC Claim Ruling Should Be Reversed

LSW argues a reasonable consumer could not have expected the reduction or elimination of the MAC charge to be guaranteed because the illustration states "interest rates, dividends, or values" are "not guaranteed," unless they are "clearly labeled as guaranteed." LSW43. But the MAC charge is not an "interest rate, dividend, or value." The term "charges" is a statutory term that is distinct from "values." Insurance Code Section 10509.953(f)&(m) (referring separately to "values" and "charges"). Accordingly, the word "values" is used consistently in LSW's illustration and the Illustration Statute to refer to the accumulated cash values or the surrender value of the policy.

Further, Section 10509.956(a)(7) states that any nonguaranteed elements shown in an illustration "shall be clearly labeled as such," so it would be unlawful for LSW to apply its generic statement about "interest rates, dividends, or values" to the MAC charge reduction because the generic statement is not a clear label that the reduction is nonguaranteed.

LSW also asserts it does not use an asterisk (*) "throughout the illustration" to denote any values that are not guaranteed, and only uses the asterisk on particular charts. But LSW uses the asterisk wherever non-guaranteed benefits or values are shown in the illustration; the MAC charge is not asterisked. TX4 LSW00001997-98.

LSW also argues that it intended to implement the elimination in the MAC charge, and Plaintiffs were not damaged because they did not hold the policies until the eleventh year. But Plaintiffs alleged that a nonguaranteed future charge reduction is less valuable than a guaranteed reduction, and that this affected the prices that the policies could command.

C. The Court Erred In Decertifying The Subclass

1. The Time And Cost In Determining The Identity Of Subclass Members Is A Question Of Manageability

The potential difficulty of identifying particular members of the subclass must be addressed under the manageability component of Rule 23(b)(3)'s superiority requirement and weighed against the benefits of the class device. *Mullins v. Direct Digital, LLC*, 795 F.3d 654, 664-65 (7th Cir. 2015); *Young v. Nationwide Mut. Ins. Co.*, 693 F.3d 532, 539-40 (6th Cir. 2012). LSW concedes the court did not conduct this analysis, as it only compared the administrative inconvenience of determining class membership to what it perceived to be the "simple" nature of common issues, instead of comparing the inconvenience to the efficiencies of class treatment. ER447 5; *Cf. Mullins*, 795 F.3d at 663-65.

LSW contends that *Mullins* does not cast doubt on the court's decision in this case because *Mullins* concerned the "*implied ascertainability requirement*." LSW47. LSW is incorrect because *Mullins* squarely rejected the contention advanced by LSW and accepted by the district court that "class certification should be denied if the plaintiff fails to show a reliable and administratively feasible way to determine whether a particular person is a member of the class." *Mullins*, 795 F.3d at 661.

Like the implied ascertainability requirement in *Mullins*, the decision in this case to treat administrative inconvenience as solely an issue of predominance "renders the manageability criterion of the superiority requirement superfluous." *Id*. at 663. It also "conflicts with the well-settled presumption that courts should not refuse to certify a class merely on the basis of manageability concerns." *Id*. at 663 & 666 (citing *Astiana v. Kashi Co.*, 291 F.R.D. 493, 500 (S.D. Cal. 2013) ("If class actions could be defeated because membership was difficult to ascertain at the class certification stage, there would be no such thing as a consumer class action."); *Lilly v. Jamba Juice Co.*, 2014 WL 4652283, at *4-6 (N.D. Cal. Sept. 18, 2014); *In re ConAgra Foods, Inc.*, 302 F.R.D. 537, 565-67 (C.D. Cal. 2014).

LSW incorrectly reads *Mazza* and *Berger* to mean that determining whether a subclass member has been exposed to the wrongdoing is always a question of predominance. *Mazza v. Am. Honda Motor Co.*, 666 F.3d 581, 595-96 (9th Cir. 2012). *Mazza* and *Berger* concerned a situation, not present here, where some members of the class were not exposed to wrongdoing at all. Because the class in *Mazza*, for example, was defined to include "many class members [who] were never exposed to the misleading advertisements," a presumption of classwide reliance was inappropriate and "common questions of fact do not predominate where an individualized case must be made for each member showing reliance." *Mazza*, 666 F.3d at 596.

Unlike *Mazza*, here the subclass is "defined in such a way as to include only members who were exposed to [an illustration] that is alleged to be materially misleading." *Id*. at 595; *Johns v. Bayer Corp.*, 280 F.R.D. 551, 558 (S.D. Cal. 2012). This complies with *Mazza's* dictate to limit the subclass to individuals exposed to sales illustrations, and the court correctly found the subclass was entitled to a presumption of reliance. ER353 22-25, 39. This case is unlike *Mazza* and *Berger*, but similar to *Mullins*, because it is undisputed that all members of the subclass were exposed to the deception and the sole question is whether the administrative inconvenience in identifying subclass members necessitated decertification.

Identification of members of the class or subclass is an issue in nearly all class actions, and identification is frequently difficult. Treating identification of class members as an issue of manageability is necessary to avoid substantial impairment of the class action device.

2. LSW Concedes The Court Erred By Contending That The Feasibility Of File Review Is "Irrelevant"

LSW asserts, "Plaintiffs' argument that manual review of policy files would be feasible is irrelevant" (LSW48), but the sole basis for the court's decision was that the file review was not feasible. The order to show cause concerned whether "file review would be an overwhelming task." ER417 at 2. The decertification order was based solely on the "time and volume" of files to be reviewed. ER447 1-2.

LSW wishes that the court had grounded its decision on *Mazza*. But the court previously rejected LSW's reliance on *Mazza* in granting certification and did not cite *Mazza* in decertifying.[8]

3. LSW's Argument About The "Variation Among Sales" Is Incorrect And Unsupported

LSW argues that "policy sales were highly varied," but this was not the basis for decertification. Indeed, as the court correctly recognized, ER353 36-37, uniform written communications (e.g., illustrations) can support class treatment regardless of whether oral communications vary. *Yokoyama v. Midland Life Insur. Co.*, 594 F.3d 1087, 1093 (9th Cir. 2008). Although variations in oral sales presentations "might be persuasive if plaintiffs' claims arose exclusively from the oral representations of agents," plaintiffs' showing that they "received uniform written materials . . . is sufficient to sustain class certification even when there may

[8] LSW also distorts the record about feasibility. It states the review could adjudicate pre-sale illustration 72% of the time, but leaves 28% of the subclass "unaddressed." LSW49. But the court previously held the remaining 28% could submit affidavits, and it did not revisit this ruling. ER353 33. LSW argues that one aspect of Walker's file was inaccurate, but it is undisputed she received a pre-sale illustration. LSW asserts that even if an illustration was printed, there might be a question of whether a policyholder received it, but this is speculation. If a box on the application is not checked, "the agent and applicant have both certified that an Illustration matching the Policy was provided to the applicant." ER353 31-32. And an Agent's Report "also establishes subclass membership," where it contains a notation that an illustration was used with the policyholder. *Id*. 31-32 & n.16. LSW asserts there were "dozens of disputes," LSW49 n. 24, but in all but one case, one or more of the pertinent documents clearly established subclass membership. Op. 41.

be some diversity in accompanying oral communication." *Iorio v. Asset Mktg. Inc.*, 2006 U.S. Dist. LEXIS 94948, *14-15 (S.D. Cal. July 26, 2006); *In re Nat'l W. Life Ins. Deferred Annuities Litig.*, 268 F.R.D. 652, 664-68 (S.D. Cal. 2010); *Occidental Land, Inc. v. Superior Court of Orange County*, 18 Cal. 3d 355, 361 (Cal. 1976); *c.f. McAdams v. Monier, Inc.*, 182 Cal. App. 4th 174 (2010).

Further, even if LSW were correct that there was variation in oral disclosures, this would be irrelevant as a matter of law under *Chern* and *Williams*, which prohibited the use of deceptive written misrepresentations even though the truth was also disclosed.

IV. Plaintiffs' Volatility And Tax Defect Claims

A. Exclusion Of Key Evidence

1. 90% Of The Class Would Never Receive Tax Benefits

LSW argues that its projection that 90% of policyholders would not receive tax benefits was not based on volatility risk, but this evidence was important to demonstrate that lapse risk was very high in general, and lapse risk due to volatility would only make the lapse risk even higher.

Evidence of LSW's lapse and lapse/surrender rates was important not just to support Dr. Brockett's testimony about the riskiness of LSW's policies and their lapse prone nature, but also to show the impact of LSW's misrepresenting and hiding its fees in its illustrations. LSW fatuously claims that "a policy lapses only if a policyholder chooses not to fund it," LSW1, but lapse is determined by both premiums in and fees out. Premiums are themselves a function of fees because consumers will stop paying premiums if they perceive that fees are consuming too much policy value. That explains why LSW's lapse rates are so high and why LSW's illustrations hide its fees.

LSW argues that Dr. Brockett inappropriately used "actual ex post experience to disaggregate surrenders and lapses," but Dr. Brockett used three different sources (comprehensive life insurance industry data, LSW's own life insurance experience, and LSW's actual experience with Provider and Paragon), which demonstrated that lapses consistently make up at least 80% of lapse/surrender statistics. LSW offered no basis for disputing this.

2. Illustrated Values Are A "Hallucination"

LSW argues this email is not relevant, but LSW is merely putting its spin on evidence that should have been heard by the jury. The email on its face states that it applies to all illustrations and that the values depicted in IUL illustrations are a hallucination.

3. LSW's Experience with Monte Carlo Simulations

LSW argues that a presentation to LSW employees about Monte Carlo simulations and volatility risk, and documents showing its sister companies' use of Monte Carlo simulations are irrelevant, but this evidence would have demonstrated that the use of Monte Carlo simulations is generally accepted science rather than an academic theory as LSW argued at trial.

B. Named Plaintiffs' Individual Volatility And Tax Claims

LSW does not dispute that the policies were marketed and sold to the named Plaintiffs based on LSW's "Tax-Free Retirement" marketing strategy, which touts the use of policy loans to obtain tax-free retirement income. ER812 20:16-22:6; ER809 84:12-89:13, 71:22-75:2, 216:2-226:4-14; ER820 116:19-23. LSW's agents "focused [Plaintiffs'] attention to the Current Basis B values" depicted in the illustration, which projected – based on the historical performance of the S&P – substantial retirement income. *Id*.

LSW's agents testified they did not disclose volatility risks because LSW did not disclose to its agent force that the policies might lapse even if the S&P performed on average in the future as it had in the past. ER809 46:23-54:19, 76:24-77:23; ER820 87:8-94:24&120:20-24. But Monte Carlo simulations, which are standard in the financial industry and used by LSW for its internal purposes, establish that if Spooner paid the premiums and took the policy loans in her illustration, her policy had a 64% chance of lapse by her life expectancy; for Howlett and Walker, the risk was 58% and 61%, respectively. ER806 24:3-26:12; TX292 LSW00018179 &182; ER811 189:1-195:19.

LSW responds that only the Current Basis B figures depicted no risk of lapse, but LSW ignores that Current Basis B is the only basis that reflects how the policy's index crediting actually works and is what the Plaintiffs actually relied on. ER806 150:11-13; ER807 142:3-153:11, 191:9-194:23. Indeed, for a consumer to expect anything other than Current Basis B is improbable because it would presume the consumer could predict the future (whether future S&P performance would be better or worse than historical performance).

LSW also argues that the Plaintiffs' policies would have performed well (based on the strong performance of the S&P to the time of trial) if they had kept them in force. But even assuming Plaintiffs had paid all their illustrated premiums, they still would face a substantial probability of lapse prior to their respective life expectancies: the risk of lapse would have been 71% (Spooner), 61% (Walker), and 56% (Howlett). ER806 66:16-69:4; ER809 206:8-208:12. If all illustrated premiums are paid, volatility does not produce lapses in the first ten years. ER806 161:18-163:3. Volatility risk becomes greater over time as cost of insurance charges increase exponentially, by over 11,000% in Walker's case. ER806 58:3-60:8; ER807 197:10-198:11.

1. LSW Doesn't Disclose Volatility Risk

LSW is wrong that "LSW's disclosures either addressed Plaintiff's points or were simply another way of making those points." LSW30. LSW's disclosures concern the risk the market may not perform as "favorabl[y]" as shown in the illustration because the historical performance of the S&P is not a representation of "future performance" or an "estimate of the returns that a policyholder can expect." LSW29-31. Plaintiffs' claims concern the different and independent risk resulting from volatility *even if* the market performs on average as favorably as shown in the illustration. ER806 84-86. While a reasonable policyholder would understand from LSW's illustration that they would receive a different outcome if the S&P did not perform at the average rate depicted in Current Basis B (e.g., 7.5%), this would not alert them to the risk of lapse and reduced value due to volatility even if the S&P performed on average at the rate depicted in Current Basis B (e.g., 7.5%).

LSW's own witnesses admitted its disclosures did not address volatility risk. ER810 206:2-218:21. While LSW's illustrations are clear that its Current Basis B figures only assume, and do not guarantee, that the S&P will perform on average in the future as it has in the past, LSW does not, and cannot, dispute that its assumption of no volatility in the S&P hides material risks of lapse that are not reflected in the illustrated values. As Dr. Brockett testified, a "reasonable consumer would never be able to understand that." ER805 130:19-131:1; ER806 79:15-82:17, 121:6-17; ER808 24:12-22.

2. The Insurance Code Does Not Prohibit Monte Carlo Simulations

LSW contends the Insurance Code makes it unlawful to disclose to consumers that LSW's policies have a specific and discernable lapse risk (e.g., 60%) as a result of volatility. But, as LSW concedes, the cited Code provisions predate the existence of IUL products. This alone is ground for reversal because a statutory provision cannot defeat liability under the UCL unless the Legislature specifically considered the issue in enacting the statute. *Cel-Tech Comm., Inc. v. L.A. Cel. Tel. Co.*, 20 Cal. 4th 163, 183 (1999).

LSW contends the Code prohibits disclosure of lapse risk because it prohibits the disclosure of "non-guaranteed elements" that are "based on a scale more favorable to the policy owner . . . at any duration." Although this provision was designed to prevent insurers from representing that consumers could gain more money than is supported by historical performance (i.e., the current scale), LSW claims it prohibits disclosure of a numerical risk of lapse (e.g., 50%) because "non-guaranteed elements" is defined to include "values" and Merriam-Webster defines the term "value" as a numerical quantity that is determined by calculation or measurement. LSW34. LSW's interpretation would violate standard principles of statutory construction because "non-guaranteed elements" are defined in the Code to include a number of other things in addition to values, such as "premiums, benefits, values, credits or charges," Ins. Code § 10509.953(m), and LSW's dictionary definition of values would subsume all those terms (e.g., "premiums" are also a numerical quantity determined by calculation) and render them a nullity. LSW cannot dispute that the term "values" in Section 10509.953(m) is a term of art referencing the cash values (either accumulated cash values or cash surrender values), and the term is used that way consistently throughout LSW's illustration and the Illustration Statute.

LSW's argument is also incorrect because it depends on LSW's assertion that Dr. Brockett's Monte Carlo simulations "assume returns *in some years* above the disciplined current scale," LSW24, but Dr. Brockett does not assume returns above the current scale for any years – only for individual simulations. Dr. Brockett ran 10,000 simulations of policy performance – while the vast majority of simulations resulted in performance lower than LSW's current scale, a few simulations resulted in better performance. But even for those few simulations, the lapse risk statistic is not based on application of a scale that is more favorable to the policyholder in any particular year or at "any duration." Amicus Brief of Society 14-17.

LSW asserts that the brief of the Society of Financial Services Professionals "is irrelevant because it discusses an 'HVC' Monte Carlo product that has nothing to do with this case." LSW25 n.14. But the Society's HVC Monte Carlo is nearly identical to the Monte Carlo used by Dr. Brockett, and the ruling would make it unlawful for the Society to use it.

C. Classwide Volatility And Tax Claims

1. Dr. Brockett's Testimony

LSW's criticisms of Dr. Brockett's methodology, which the court adopted, fundamentally misunderstand his approach.

Misleading the Jury: Dr. Brockett's testimony regarding LSW's actual lapse rates has nothing to do with his Monte Carlo analysis that is the crux of the volatility claim. LSW falsely claims that Dr. Brockett "testified on direct that he analyzed the Policies' lapse rate during the first four years only." LSW16. In fact, he was *asked* only about the first four years on direct (ER806 71:14-73:17); he then testified regarding the lapse rates in years five and six on cross-examination. ER807 10:11-15:3. While these lapse rates were interesting as background, they were not relevant to Dr. Brockett's model because they did not cover years ten and later, which is when volatility begins to affect the rate of lapses. ER806 161:18-163:3.

Paying more money or taking less in loans: LSW argues policyholders could avoid policy lapse by paying more money or taking less in loans than their illustration depicted, but if a policyholder can keep the policy alive only by paying more or taking less than they expect, this is a reason the policy fails to fulfill justified expectations. LSW misleadingly asserts "Brockett admitted that if a policyholder funded the policy or chose not to take loans, he or she could ensure that the policy would not lapse"; he actually said this would be true if a policyholder "maximally funded the policy." ER791 26:1-4. Dr. Brockett's methodology demonstrated that, if a policyholder makes the premium payments and takes the loans depicted in the illustration, there is an undisclosed (a) risk of lapse of 55.7% (Paragon) to 59.8% (Provider); and (b) 90-95% risk of reduced value. ER806 20:15-33:8. LSW's observation that a consumer could always funnel more money into the policy is both self-evident and irrelevant.

Sample: The sample is indisputably a random sample of the *relevant* population of illustrations because it contains *all* those illustrations in the random sample of 280 sales illustrations that included loans or withdrawals. These illustrations *and only these illustrations* provide data about how the policy functions when used for retirement income. LSW contends that the approximately 55%-60% failure rate says nothing about the likelihood of failure if a policy is not used for retirement income through loans or withdrawals, but that misses Plaintiffs' point in using the statistic, which was to show the propensity of the policies to fail if used for retirement income. The fact that a consumer may not have received an illustration depicting loans does not mean that they are uninterested in taking loans in the future or unconcerned about the high risk of lapse that would result.

5%-10% chance policy performs better: LSW argues that a 90-95% risk of reduced value means at least 5% of policyholders will achieve better results than illustrated. LSW26. But the 5-10% does not represent actual outcomes that anyone has experienced; they are simply data points that demonstrate risk. In the illustration (i.e., without volatility), policy performance is deterministic, not probabilistic, so assuming that the S&P performs in the future at the same average as in the past generates a specific number as the expected value of the cash flows from the policy. ER806 96:1-99:3. In the real world, the expected value of the policy is 90-95% likely to be lower than depicted in the illustration. ER806 20:15-33:8. Being told that one will receive $100,000 from making a certain investment is very different from being told that the investment has a 90% chance of being worth $70,000 or less, and a 10% chance of being worth $110,000. ER806 14-17&19-23; ER807 202:21-207:21, 216:3-222:23; ER808 12:7-13:20. A high risk of potential lapse or reduced value is material to all, even if some might end up lucky enough to escape unscathed.

2. Consumer Expectations

LSW asserts that Plaintiffs failed to establish that the volatility risk was contrary to consumer expectations, LSW32, but these risks are inconsistent with the nature of the product and the expectations created by LSW's documents. *Mass. Mut. Life Ins. Co. v. Sup. Ct.*, 97 Cal. App. 4th 1282, 1292 (2002).

The policy design reflects the product's intended use as safe and secure tax-free retirement vehicles, and the LSW employee who designed the policies testified that "obviously an IUL policy doesn't make any sense for" consumers who don't expect cash value accumulation. ER812 Tivilini Dep. 55:12-24. The testimony of LSW's employees and its internal documents state that all policyholders "share the same concerns," want to avoid "a volatile market," and that obtaining "tax-free retirement income" is "[o]ne of the principal reasons" consumers purchase. TX804 LSW00013844; TX441 LSW-E00074071; ER811 220:17-221:15; ER812 20:16-22:6. The Plaintiffs' testimony that they would not have purchased the policies if they had known the truth is consistent with these expectations, unlike the idiosyncratic expectations at issue in cases cited by LSW.

LSW's documents also purport to explain the functioning of the policies in providing for retirement income through the use of policy loans, and consumers would expect them to be fit for this ordinary and intended purpose. The illustrations themselves, and the testimony of the Plaintiffs and their agents, establish that the illustrations play a role in establishing the reasonable expectations of the class because they effectively disguise risks inherent in the policies. Dr. Brockett also testified that consumers would never be able to discern volatility risk without access to LSW's proprietary illustration software. ER805 130:19-131:1.

LSW also asserts Dr. Brockett's reduced value methodology is flawed because it compared amounts depicted in the Current Basis B column with amounts policyholders would obtain under conditions of S&P volatility, LSW26, even if the S&P average was the same as depicted in the illustration. But Current Basis B is the only measure of how the policy performs based on returns from the equity-index, which is the way the policy functions. Further, no reasonable consumer would consider the Guaranteed Values to accurately depict how the policies are likely to perform because the Guaranteed Values are a statistical impossibility. ER807 191:9-193:14; ER808 7:6-24; ER810 162:14-25; ER812 Tivilini Dep. 55:12-56:1. No reasonable consumer would consider Current Basis A to accurately depict policy performance because Current Basis A is based on the interest rate charged when policyholders take loans, and has nothing to do with how the equity-indexed strategies accumulate interest. ER806 150:11-13; ER807 142:3-153:11, 191:9-194:23. Plaintiffs and their agents testified that they considered only Current Basis B for these reasons. ER808 86-87, 154-155, 215-216; ER809 88-91, 133-38, 216-217, 221:3-16, 226:4-14, 231:24-232:13.

LSW argues that a "non-uniform sales process inherently defeats Plaintiffs' class-wide omission theory," LSW28-29, but there was not a lack of uniformity in disclosures about volatility risk. LSW provided the class with a standard set of documents that did not disclose volatility risk (the materiality of which created a presumption of classwide reliance, ER353 at 23-24 n.15), LSW's agents testified that they were never apprised of volatility risk, and there was nothing in the record to suggest that even a single agent or policyholder was alerted to the risk.

March 23, 2016

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