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

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CORPORATE DISCLOSURE STATEMENT

This statement is made pursuant to Federal Rule of Appellate Procedure rule 26.1. Plaintiffs-Appellants are not corporate entities and therefore have no parent corporation(s), subsidiaries, or affiliates that have issued shares to the public.

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INTRODUCTORY STATEMENT

This appeal concerns Life Insurance Company of the Southwest's ("LSW") deceptive sales of equity-indexed life insurance policies and a series of reversible errors that leave over 44,000 California class members without any remedy. LSW deceives consumers by distributing policy illustrations that project investment gains and tout the policies as lucrative tax-free retirement vehicles. But LSW fails to disclose material facts about the policies' risks, income crediting methods, significant fees, despite LSW's internal projections that at least 72-75% of policyholders will not obtain the touted tax benefits.

The financial consequences for retirement savings are devastating: named plaintiffs Joyce Walker and Muriel Spooner lost $81,366 and $54,686.83 respectively, before surrendering their policies, and named plaintiff Kim Howlett lost his entire investment of $106,750. ER669. In the first year, the named plaintiffs were charged $25,204.26 (Howlett), $12,507.23 (Spooner), and $19,606.58 (Walker) in fees, or roughly $12,000 (Howlett), $6,000 (Spooner), and $6,000 (Walker) more than the amount of the one policy fee that was shown in their illustrations. By the time of trial, class members had already paid $129,534,499 in fees to LSW. ER806 at 48:7-49:10.

The district court committed reversible error in regard to three claims:

(1) LSW requires that all policyholders receive an illustration when the policy is delivered, but the illustration violates numerous provisions of the California Insurance Code. The court, however, disregarded decisions of the California Supreme Court and this Court in granting a motion to dismiss and holding that claims under California's Unfair Competition Law ("UCL") cannot be predicated on violations of any statute that lacks a private cause of action.

(2) LSW does not require that consumers receive an illustration before applying for the policies, but LSW's files establish that at least 72% of class members received a pre-sale illustration. In regard to Plaintiffs' claims that LSW conducted a bait and switch scheme that baited consumers with a deceptive pre-sale illustration and only later provided truthful disclosures, the court gutted the California Supreme Court's prohibition on bait and switch schemes by holding after a bench trial that the named plaintiff's individual claims failed as a matter of law because the subsequently delivered disclosures immunized LSW from liability for the deceptive illustration. The court also misapplied Rule 23 in decertifying this subclass because the court believed it would be administratively inconvenient to identify subclass members from LSW's files.

(3) LSW does not disclose the risks that arise from the interaction between the policy design and stock market volatility, or the adverse tax consequences that result from this substantial risk. But the court abused its discretion and severely

prejudiced Plaintiffs' case by excluding the most probative evidence of LSW's wrongful intent, including LSW's own internal projections that very few policyholders will obtain the touted tax benefits, from a jury trial of Plaintiffs' common law fraud claim. It also erred in rendering a defense verdict under the UCL on these same claims, holding among other things that a statutory provision that was designed to promote disclosure to policyholders in fact affirmatively bars LSW from providing effective disclosure of volatility risks.

STATEMENT OF JURISDICTION

The district court had jurisdiction under 28 U.S.C. §1332(d)(2)(A) and was obligated to apply the substantive law of California. This Court has jurisdiction pursuant to 28 U.S.C. §1291.

The district court entered a final judgment on May 4, 2015. ER793. Plaintiffs filed a timely notice of appeal on May 29, 2015. ER797; FRAP 4(a)(1)(A).

STANDARD FOR REVIEW

Dismissal under Rule 12(b)(6) and Rule 12(c) is reviewed de novo. *Doughtery v. City of Covina*, 654 F.3d 892, 897 (9th Cir. 2011); *Lyon v. Chase Bank USA, N.A.*, 656 F.3d 877, 883 (9th Cir. 2011).

Decertification of Plaintiffs' bait and switch claims is reviewed for abuse of discretion. *Parra v. Bashas', Inc.*, 536 F.3d 975, 977 (9th Cir. 2008). A court

abuses its discretion if it applies an impermissible legal criterion. *Hawkins v. Comparet-Cassani*, 251 F.3d 1230, 1237 (9th Cir. 2001). The court's decision must be supported by sufficient findings to be entitled to deference. *Narouz v. Charter Communications, LLC*, 591 F.3d 1261, 1266 (9th Cir. 2010).

The court's conclusions of law regarding Plaintiffs' volatility and tax claims and Plaintiffs' individual bait and switch claims are reviewed de novo. *Husain v. Olympic Airways*, 316 F.3d 829, 835 (9th Cir. 2002). Findings of fact are reviewed for clear error. *Id*. at 835. Mixed questions of law and fact are reviewed de novo. *Lim v. City of Long Beach*, 217 F.3d 1050, 1054 (9th Cir. 2000).

The court's evidentiary rulings are reviewed for abuse of discretion, and reversal requires a showing of prejudice. *Harper v. City of Los Angeles*, 533 F.3d 1010, 1030 (9th Cir. 2008). Prejudice means that, more probably than not, the error tainted the verdict. *Harper*, 533 F.3d at 1030.

ISSUES PRESENTED FOR REVIEW

I. Did the court commit reversible error in ruling, and refusing to reconsider its decision based on intervening authority, that Plaintiffs could not predicate UCL claims on Section 10509.950, et seq., of the California Insurance Code because the statute lacks a private cause of action?

II. Did the court commit reversible error in its treatment of Plaintiffs' bait and switch claims by:

(a) holding that deceptive representations are not actionable if the truth is later disclosed;

(b) holding that LSW's representation in its illustration of a reduction or elimination in the Monthly Administrative Charge was not deceptive because of a "clear disclaimer" that the reduction or elimination was not guaranteed, when no such disclaimer exists; and

(c) holding that administrative inconvenience in identifying subclass members required decertification, even though common issues of law and fact otherwise predominated and the manageability component of Rule 23(b)(3)'s superiority requirement was not considered?

III. Did the court commit reversible error in its treatment of Plaintiffs' volatility and tax defect claims by:

(a) excluding critical evidence to the prejudice of Plaintiffs;

(b) holding that LSW's illustration adequately discloses the risks;

(c) holding that the Insurance Code affirmatively bars disclosure that is based on Monte Carlo analysis; and

(d) imposing incorrect requirements for class proof?[1]

[1] Pertinent statutes are set forth in a separately bound Addendum, per Circuit Rule 28-2.7.

STATEMENT OF THE CASE

I. LSW's IUL Sales

LSW sold the policies to approximately 44,000 California policyholders. Equity-indexed universal life insurance ("IUL") is the "the number one selling product in the [insurance] industry" (TX295 at LSW 00025258), and LSW is the "[t]hird leading distributor." TX2 at LSW-E00014879.

A. The Mechanics of IUL Policies

Unlike traditional term life insurance, which provides coverage for only a defined period of time, universal life offers the option of lifetime insurance, borrowing against the cash value accumulation of the policy, and flexible premium payments. IUL accumulate interest based on the performance of a market index (typically, the S&P500) with a participation rate,[2] cap,[3] floor,[4] and a minimum guaranteed rate of accumulation.

IUL policies share common features, although the policy parameters (the cap, guarantee structure, and fees) differ. Policy value goes down if fees are greater than the interest that is credited to the account.

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[2] A multiple applied to index performance. A participation rate of 140% means that cash value will grow 40 percent greater than the index. TX30.010-11 & TX86.0004.

[3] A cap limits the credited interest in any given policy year. A 10% cap limits returns to only 10% even if the S&P500 returns 12%.

[4] A floor of zero means that a policy will not be credited negative interest if market returns are negative, although the floor does not prevent loss in value due to fees.

Premiums are typically paid with after-tax money and grow tax exempt because of the tax-favored status of life insurance. If there is sufficient cash value, funds (e.g., for retirement) can be taken out as a loan without paying taxes on the earnings as long as the policy is in force (because loans are tax-free). ER805 at 124:24-128:5; 150:22-152:14. If the policy is still in place when the insured dies, the death benefit pays off the loan, whatever is left is paid tax-free to the beneficiary, and no taxes are owed. ER805 at 150:22-152:14.

Lapse occurs if fees consume the cash surrender value. Surrender occurs if the policyholder withdraws money and discontinues the policy. ER805 at 148:8-149:4. The policyholder will owe taxes upon lapse or surrender if there is an outstanding loan above the policyholder's basis (i.e., amount of premiums paid) because the only way to obtain the tax benefit is for the insured to die with the policy in force. ER805 at 149:12-150:12, 152:15-153:3. Taxes on the gain are owed at "ordinary income" rates (up to 39.6%), instead of "capital gain" rates (approximately 20%). *Id.*

B. LSW's Tax-Free Retirement Marketing Strategy

LSW uses a "Tax-Free Retirement" marketing strategy. ER810 at 156:19-158:7; ER811 at 210:9-213:1, 217:17-220:16; ER812 at 14:2-11, 18:1-22:6; ER735-2 at 37:12-21; ER802 at 70:22-71:4; ER820 at 120:25-122:20; TX2 at LSW-E00014869; TX38. LSW's "success story recipe" for its agents is to

promote the use of the policies for tax-free retirement income. ER812 at 20:16-22:6.

LSW's SecurePlus Paragon Buyer's Guide explains that all consumers "share the same concerns" about "financial security" that are purportedly addressed by the ability to obtain "[t]ax deferred accumulation of cash value," "[a] guaranteed minimum interest rate should the S&P500 Index decline or remain level," and "[t]ax free distribution of cash value through loans or withdrawals." TX804 at LSW00013844; TX441 at LSW-E00074071; ER811 at 220:17-221:15. Michael Tivilini, the actuary who designed the policies, testified that if a consumer is not interested in "cash value accumulation, then obviously an IUL policy doesn't make any sense for them." ER735-2 at 55:12-24.

IUL sales are exploding because "Consumers Began To Demand Upside Potential with Downside Protection," and expect IUL policies to be relatively safe and secure retirement vehicles. TX295 at LSW00025258. Safety is conveyed by LSW's "SecurePlus" trade name and by the basic concept and structure of the policies, which are represented to provide downside protection with a floor on index earnings coupled with minimum guarantees. ER806 at 152:2-155:6; TX295 at LSW00025258-59; TX441 at LSW-E00074058; ER810 at 158:8-14; ER811 at 199:18-25; TX804.0004. As the court noted, "the purpose of the products is to

provide some limited market exposure by eliminating downside risk." ER791 at 17.

C. LSW Uses Illustrations To Market And Sell The Policies

LSW induces consumers to apply for and purchase the policies through a standardized printed illustration that is distributed to prospective policyholders by agents who use LSW's computer illustration software. ER805 at 155:25-156:20. The second page of the illustration touts "Retirement Income," and "[c]ash accumulation for additional retirement income, college expenses or to meet emergencies." TX4 at LSW 00001985; ER805 at 156:21-160:4.

Numbers displayed next to the Retirement Income bubble display an amount of "Cash Value Accumulation" that a policyholder can expect to obtain, which is calculated based on the "Current Basis B values." *Id*. The Current Basis B values also are reflected in a number of pages of tables that provide a mathematical calculation of how the cash value of the policy can be expected to perform in each year over time.

The mathematical calculation of the Current Basis B values is conducted based on a "lookback" rate that is derived from the historical performance of the S&P500. The lookback method runs the historical performance of the S&P500 over a certain period of time through the parameters of the policies (participation rate, caps, and floors), in order to obtain an average interest rate that the policies

would have performed at based on the historical returns. The illustration assumes that a policyholder would obtain that constant average interest rate each and every year going forward, and that interest rate is used to project the investment gains that a policyholder can expect to obtain in light of the timing and amount of the policyholder's anticipated premium payments that are inputted into the illustration software by the agent. ER805 at 155:25-156:20; ER810 at 160:14-162:1.

In addition to the Current Basis B values, the illustration contains tables with two other scenarios of policy performance: Guaranteed Values and Current Basis A. TX4. Guaranteed Values assume an annual interest rate of 2% (Provider) or 2.5% (Paragon). Current Basis A assumes an annual interest rate that is equivalent to LSW's loan rate. *Id*. All three of the illustrated scenarios use a constant interest rate and do not incorporate S&P500 volatility. ER807 at 143:8-17; ER810 at 182:5-16.

LSW requires only that policyholders receive an illustration at the time that the policy is delivered (a "batch illustration"). However, most consumers also receive an illustration in the pre-sale process because an illustration is the only document that shows the mechanics of the policy and provides information about how guaranteed and nonguaranteed policy values can be expected to change over time based on a specified funding pattern. ER810 at 160:14-162:1; ER735-2 at 118:23-119:13; ER809 at 75:21-76:11. LSW's files establish that at least 72% of

policyholders receive an illustration prior to application. ER420-15 at ¶9; ER806 at 19:10-20:14, 37:24-38:20, 39:20-40:8, ER807 at 77:7-19; ER802 at 106:19-22. Batch and pre-sale illustrations are largely identical, with the exception that the batch illustration is automatically produced in batches at LSW's home office and may not reflect the pattern of premium payments and loans that is discussed by the policyholder and agent and illustrated in the pre-sale process.

II. Plaintiffs' Class Claims: The Volatility And Tax Defects

LSW never discloses that the interaction between the policy design and natural S&P500 volatility creates a significant risk that the policies will suffer (a) reduced value or (b) lapse, and this creates a significant tax risk that the policyholder will pay substantial taxes (at ordinary income rates) on any loan outstanding at the time of lapse, or be shackled until death to LSW's significant and increasing fees to avoid the adverse tax consequences.

These undisclosed risks are not the risk that the policy will perform poorly if the average return in the S&P500 turns out to be less than the historical average. They are entirely different risks that afflict the policies even if the S&P500 performs on average in the future at the same rate that it has in the past.

The risk of reduced value and lapse is reliably quantified with Monte Carlo simulations, which are "used traditionally in almost all financial analyses" and "virtually every discipline." ER805 at 192:18-195:8; ER810 at 182:17-22; ER811

at 182:13-17; ER812 at 30:5-31:10; ER735-2 at 130:23-131:3. Monte Carlo simulations run many (in this case, 10,000) individual simulations in which the S&P500 returns vary each year, while still having the same mean and standard deviation as the historical returns. ER805 at 192:18-198:14; ER806 at 161:18-163:3. Monte Carlo simulations can be used to calculate (1) a "lapse probability" reflecting the percentage of the simulations in which the policy values were insufficient to pay fees; and (2) an average policy value across all simulations that can be compared to the value stated in LSW's illustration.

LSW itself uses "randomly generated stochastic [i.e., volatile] future scenarios" of S&P500 returns to project whether its hedging strategy is adequate to pay what it may owe to policyholders. TX292 at LSW00018179 & 182; ER811 at 189:1-195:19. For its own computations (as opposed to those provided to policyholders), LSW "want[s] to look at a wide range of possible future scenarios." ER811 at 196:9-17.

Monte Carlo simulations establish that if named plaintiff Spooner paid the premiums and took the loans shown in her illustration, her policy has a 64% chance of lapse by her life expectancy; for plaintiffs Howlett and Walker, the risk is 58% and 61%, respectively. ER806 at 24:3-26:12. The prospects for other class members whose illustrations included loans are similar: 55.7% (Paragon) to 59.8% (Provider) would lapse before life expectancy. ER806 at 27:1-21.

Monte Carlo simulations also establish that there is a 95% (Provider) and 90% (Paragon) chance of reduced policy value because volatility systematically biases policy performance in a negative direction. ER806 at 20:15-21:5, 22:5-15. Due to volatility, the average policy value will be reduced 33.3% (Provider) and 31.4% (Paragon). ER806 at 103:17-107:4. These statistics are drawn from a statistically significant sample that includes both illustrations that depict loans and those that do not depict loans. ER806 at 20:15-21:5, 22:5-15.

This undisclosed risk results from interacting policy features. First, constant deduction of fees means that the sequence of returns matters, so even if the returns averaged 7% per year over the life of the policy, one sequence with low returns in the early years may produce a substantially lower account value than a sequence with high returns in the early years. ER805 at 116:9-124:12; ER806 at 44:23-45:12. LSW's fees are enormous: 44.3% of gross premiums paid by the Class as of the time of trial. ER806 at 48:7-49:10.

Second, LSW does not credit guaranteed interest on an annual basis, which increases the risk of lapse by leading to reduced value in years where the S&P500 returns less than the guarantee. ER805 at 143:20-147:1; ER806 at 45:20-46:6, 126:1-14; ER811 at 203:25-204:16. LSW also does not credit guaranteed interest or partial year index-earnings upon lapse, so guaranteed interest or partial year earnings cannot prevent lapse. ER735-2 at 96:25-97:12, 98:1-14. LSW admits

that the manner in which it calculates the guarantee makes obtaining the guaranteed values a statistical impossibility. TX947; ER808 at 8:2-11:1; TX221; ER811 at 200:1-201:1; ER735-2 at 163:11-165:4.

Third, a policy becomes increasingly vulnerable to lapse from volatility as the insured ages because cost of insurance charges increase exponentially; for Ms. Walker, her cost of insurance rates increase 11,000% from her issue age of 48 to age 84, so that her cost of insurance charge alone could be approximately $120,000 per year at age 84. ER806 at 58:3-60:8; ER807 at 197:10-198:11; ER810 at 242:13-245:9, 246:14-249:2.

III. The Named Plaintiffs' Bait And Switch Claims, Which The Court Decertified And Were Tried On An Individual Basis

A. Nondisclosure Of Policy Fees

The illustration does not disclose the many fees that will be deducted (including the premium expense charge, cost of insurance, monthly percent of accumulated value charge (for Paragon), and monthly policy fee). Both the second and third pages of the illustration state, in oversized and bolded type, that there is only "***One Policy Fee***." TX4 at LSW 00001985-86. The only fee that is mentioned or defined (other than the one-time fee charged on surrender) is the Monthly Administrative Charge. TX4 at LSW 00001987-90 & 00002004-2006.

LSW's illustration software is capable of producing, as part of the illustration, text that identifies each fee charged by LSW and a table that lists the

specific dollar amount of each of the fees. However, LSW programmed the default setting in its computer software so that the illustration is printed without this information; in order to disclose the fees, an agent would have to reverse the default setting in the "Optional Report" field of LSW's computer software, so that the disclosure is incorporated into the illustration. ER806 at 114:15-116:9; ER810 at 215:20-217:14; TX860. Of a statistically significant sample, only 0.5% of policyholders received an illustration that included the Optional Report. TX570-1; ER806 at 114:15-116:9. None of the named plaintiffs received this information.

B. Minimum Guaranteed Interest

The illustration represents guaranteed interest of 2% (Provider) or 2.5% (Paragon). The "Guaranteed Accumulated Values" in the illustration depict the amount of money that a policyholder would obtain based on their funding plan and an annual guaranteed interest rate, but these numbers are false because LSW only credits an average rate of return applied retrospectively over many years. ER807 at 23:19-24:8. While the illustration states that "[t]he policy as illustrated on a guaranteed basis will provide coverage for [a certain number of] policy years," in fact the policies will lapse sooner because LSW calculated the number of policy years based on an annual guarantee that it does not actually provide. ER807 at 195:6-197:9; ER808 at 11:2-12:5.

Based on the manner in which LSW actually calculates guaranteed interest, no interest would have been credited to any policyholder based on the historic returns of the S&P500. TX947; ER808 at 8:2-11:1. In contrast, a true annual guarantee would have added 42.5% in gains to policy value. ER808 at 8:2-11:1.

In internal emails, several LSW employees admitted that LSW's statements about the guarantee are "a bit ambiguous." TX8 at LSW-E00003127-29; ER810 at 227:23-230:19; ER735-2 at 48:7-50:18, 58:9-59:23.

C. Monthly Administrative Charge

LSW's illustrations depict the amount of the Monthly Administrative Charge being eliminated (Paragon) or reduced by about 60% (Provider) beginning in the eleventh policy year, but, unlike other components of the illustration,[5] nothing indicates that the reduction or elimination is not guaranteed. TX4 at LSW 00002004-2006; ER806 at 117:23-119:3; ER809 at 221:17-22. Tivilini, who designed the policies, and Craig Smith, another LSW employee, both testified that it is not possible to tell from the illustration that the reduction is non-guaranteed. ER811 at 162:17-163:24; ER735-2 at 103:3-104:20.

IV. Plaintiffs' Purchase Of Their Policies

A. Howlett And Spooner

Plaintiffs Howlett and Spooner, husband and wife, purchased their policies from an LSW agent, Jacob Cooper, who provided them with illustrations and

[5] TX4 at LSW00001997-98 (using asterisks to denote "not guaranteed").

"focused [their] attention on the current basis B values." ER809 at 20:10-21:1, 85:13-22, 88:21-89:13.[6]

Howlett and Spooner subsequently reviewed their illustrations on multiple occasions before moving forward. ER809 at 88:15-20, 90:4-20; ER808 at 84:21-85:15. Both were interested in tax-free retirement income and were not interested in life insurance because they have no children or heirs. ER809 at 71:22-75:28, 84:12-19, 86:1-9. Based on their review of the illustrations, they believed that the policy was a good retirement income investment, and they were comfortable with what they understood to be the key features. ER809 at 90:17-92:15; ER808 at 85:12-88:14. Howlett and Spooner planned to invest $423,000 and $238,000, respectively. TX4 & 30.

On October 11, 2007, Howlett and Spooner received copies of their policies and paid $105,750 (Howlett) and $59,500 (Spooner) for the first year's premium. TX888; ER809 at 92:16-24. Cooper testified that "policy deliveries are really quick" and that he provided documents in a "big plastic Ziploc kind of bag." ER809 at 73:14-74:24. Howlett and Spooner did not read the additional documents because they "thought that the policy would perform the way it was illustrated." ER809 at 92:25-93:17.

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[6] Cooper and Tivilini were unavailable for trial and testified via recorded deposition.

After each making a premium payment, Howlett and Spooner engaged a new financial advisor who expressed concerns about the policy. ER808 at 90:1-96:24. In an email to Cooper, Howlett stated that they were not "in a position to make the next payments on our life insurance policies." TX644. Howlett testified that he wrote this because his financial advisor "had told us it would be like throwing good money after bad." ER809 at 98:4-99:14.

1. The Class Claims: Volatility And Tax Defects

Cooper sold the policy based on the accumulation of tax-free retirement income as projected by the Current Basis B values. ER808 at 83:2-11, 86:25-87:8, 154:21-155:3, 161:3-7; ER809 at 88:21-89:13, 91:3-92:11, 137:19-138:4. He testified that "it's impossible to provide" consumers with information about the volatility and tax risks because LSW's illustration doesn't "present a statistical probability of achieving the outcome that's depicted." ER809 at 46:2-47:17, 48:17-50:21, 76:24-77:23. No one at LSW ever disclosed that the policy might lapse even if the S&P500 performed on average in the future as it had in the past. *Id*. at 53:18-54:19

2. The Individual Bait And Switch Claims

a. Policy Fees

Howlett and Spooner understood that the Monthly Administrative Charge "seemed like a reasonable cost, and [] liked the idea that the fees would just be encapsulated as one fee." ER809 at 110:12-17; ER808 at 112:19-114:11, 217:22-

221:2. In the first year, Howlett and Spooner were charged roughly twice the amount of the Monthly Administrative Charge alone. ER809 at 111:25-112:10; TX91; TX92; ER808 at 115:7-19.

Cooper testified that he disclosed the existence of the fees, but admitted that he did not disclose the amount of the fees because he was "not provided with the itemization of the fees" by LSW. ER809 at 61:16-25. LSW did not tell Cooper about the ability to reverse the default settings in the software and include information about fees in the illustration. *Id*. at 62:10-23.

b. Guaranteed Minimum

Howlett and Spooner both understood the illustration to represent that they would receive 2.5% guaranteed in each year that the S&P500 returned lower than 2.5%. TX30; ER809 at 115:17-116:16; ER808 at 118:18-119:15. This downside protection was an important feature. ER809 at 115:17-116:20; ER808 at 83:17-22.

Cooper stated that "[t]o the best of my memory, if the index were to credit less than two and a half percent, then the policyholder would get a credit of two and a half percent for that policy year." ER809 at 56:13-57:9, 79:25-81:14. Thus even LSW's own agent was deceived by LSW's depiction of the guarantee.

c. Monthly Administrative Charge

Howlett and Spooner both believed that the elimination of the Monthly Administrative Charge was guaranteed based on the illustration. ER809 at 114:25-

16; ER808 at 117:20-118:17. Cooper testified that he himself "do[es]n't know if [the eleventh year reduction in the Monthly Administrative Charge is] guaranteed or non-guaranteed." ER809 at 69:3-19.

B. Walker

Plaintiff Walker purchased her policy from two LSW agents, Michael Botkin and Jeff Stemler, although she primarily worked with Botkin to identify "safe and secure [retirement] possibilities" and review LSW's illustration. ER809 at 211:8-212:19, 215:21-23; ER820 at 28:10-29:18, 97:14-99:8. Walker also independently reviewed the illustration, conducted Internet research, and consulted with others in an effort to understand the policy better. ER809 at 215:21-222:12. Walker was interested in tax-free income and not interested in life insurance because she has no children. ER809 at 210:15-20, 211:8-214:21, 232:14-24. Her plan was to fund her retirement by investing $560,000 over five years. TX48 at LSW00002342.

When Walker paid the first year's premium of $112,000 and received the policy, she did not review it, believing that it "would be a reflection, a fair and accurate depiction of the illustration that I had been using for the past couple of months." ER810 at 17:22-18:3.

After making two premium payments, Walker consulted with new financial advisors and became concerned about her purchase. ER810 at 18:20-26:11. Walker subsequently surrendered and lost $81,366.21. ER810 at 38:13-24.

1. The Class Claims: Volatility And Tax Defects

Stemler sold the policy to Walker using LSW's tax-free retirement concept. ER820 at 116:19-23; ER809 at 216:2-217:12, 218:14-219:18, 221:3-16, 226:4-14. Stemler did not disclose the volatility risk because he did not know about it himself and had received no information about the risk from LSW. ER820 at 87:8-88:8, 89:23-90:25, 92:2-17, 93:25-94:24, 120:20-24.

2. Individual Bait And Switch Claims

a. Policy Fees

Walker understood that the policy had "One Policy Fee," which was the $1,072.17 amount of the Monthly Administrative Charge. TX48; ER809 at 221:17-222:6. In the first year, Walker was charged roughly $6,000 more than the Monthly Administrative Charge. TX94; ER810 at 35:5-13.

Stemler claimed to have discussed the existence of mortality costs for insurance with Walker, but the discussion was "hypothetical and generic" because Stemler did not receive information from LSW regarding the amount of the mortality costs that would be charged. ER820 at 45:19-46:17. Stemler did not testify that he discussed any of the other non-mortality based fees. Walker explained in regard to fees, "I thought that [all the fees] were included, that they

were all inclusive, all included in the monthly administrative charge." ER809 at 229:6-19.

b. Guaranteed Minimum

Based on Walker's review of the illustration, she understood that her policy would earn a guaranteed rate of 2% per year. TX48; ER809 at 218:8-13. Walker testified that Stemler never explained the calculation of the minimum guarantee. ER809 at 228:7-24. Stemler testified that, at the final meeting with Walker, he explained to her that guaranteed interest is credited in five-year segments. ER820 at 53:19-55:2. But Stemler could not recall his discussion with Ms. Walker (*Id*. at 126:10-127:1) and testified that he did not disclose that the retrospective crediting of guaranteed interest would lead to reduced policy value. *Id*. at 127:2-129:19.

c. Monthly Administrative Charge Reduction

Based on the illustration, Walker understood that her Monthly Administrative Charge would be reduced from $1,072.17 to $429.29 beginning in Year 11. TX48; ER809 at 221:17-222:6; ER810 at 34:3-12, 36:25-37:22. Stemler did not claim to have disclosed that the reduction in the Monthly Administrative Charge was nonguaranteed.

PROCEDURAL HISTORY

Plaintiffs' Complaint was initially filed in San Francisco Superior Court, removed to the Northern District, and then transferred to the Central District. ER1.

On December 21, 2010, LSW filed a motion to dismiss the complaint. ER33. The court granted LSW's motion to dismiss, in part, and denied it, in part. ER59. The court ruled that Plaintiffs could not predicate a UCL unlawfulness claim on LSW's violations of the Insurance Code because the Code lacked a private cause of action. ER59.

On June 7, 2011, Plaintiffs filed a First Amended Complaint. ER66. On July 25, 2011, LSW filed a motion for judgment on the pleadings. ER72. Extending its earlier ruling, the court concluded that Plaintiffs could not predicate a UCL unfairness claim on a statute that lacks a private cause of action. ER112.

Plaintiffs filed a Second Amended Complaint on April 20, 2012. ER205. The SAC asserted five theories – the volatility defect, tax defect, policy fees, guaranteed interest, and Monthly Administrative Charge claims. ER769.

On May 14, 2012, Plaintiffs filed a class certification motion. ER225. The court initially certified two classes, each asserting claims of common-law fraud and violations of the UCL. These two classes were: All Provider and Paragon policyholders who purchased their policies on or after September 24, 2006 (the "Pure Omissions class"), asserting the Volatility and Tax claims (the "Pure Omissions claims"); and All Provider and Paragon policyholders who purchased their policies on or after September 24, 2006, and who were provided a policy illustration at or before policy application (the "Illustrations Subclass"), asserting

the Nondisclosure of Fees, the Guaranteed Interest, and the Monthly Administrative Charge claims (the "Illustrations claims"). ER353 at 27, 40.

On April 12, 2013, the court issued an order to show cause regarding why the Illustrations Subclass should not be decertified. ER417. After the parties briefed the topic (ER420 & 421), the court issued an order decertifying the Illustrations Subclass because of administrative inconvenience in identifying who received a pre-sale illustration. ER447.

On September 9, 2013, Plaintiffs filed a motion for leave to file a Third Amended Complaint (ER464), and a motion for reconsideration of the Court's decisions on the motion to dismiss and motion for judgment on the pleadings in light of *Rose* and *Zhang*. ER463. The Court denied Plaintiffs' motions. ER478.

Trial began on April 8, 2014 and continued until April 25, 2014 (ER694, 727, 728, 736, 737, 738, 741, 745, 762, 763, and 764). The court granted LSW's motion *in limine* to exclude evidence, including LSW's internal projections that very few policyholders would obtain tax benefits. ER674. On the second day of trial, the court excluded additional evidence. ER700.

On April 25, 2014, the jury returned a defense verdict on Plaintiffs' claims of fraudulent concealment. ER769. On April 14, 2015, the court issued an order finding LSW not liable on the UCL claims. ER791.

SUMMARY OF THE ARGUMENT

1. In regard to Plaintiffs' UCL claims predicated on LSW's violations of California Insurance Code Section 10509.950, et seq., the district court committed legal error in dismissing these claims on the grounds that the statute lacks a private cause of action. The very purpose of the UCL is to borrow violations of other laws even if those laws lack a private cause of action, so long as the laws do not affirmatively bar a suit.

2. In regard to Plaintiffs' bait and switch claims that were predicated on LSW's deceptive pre-sale illustration:

(a) the court committed legal error in concluding that the later disclosure of truthful information about policy fees and the guaranteed minimum rendered LSW's illustration not deceptive. As the California Supreme Court established in *Chern v. Bank of Am.*, 15 Cal. 3d 866, 876 (1976), the UCL prohibits representations that are likely to bait or entice a consumer into negotiations over a product, even where true disclosures are made before purchase.

(b) the district court committed a clear factual error in holding that LSW's representation of a reduction or elimination in the Monthly Administrative Charge was not deceptive because of a "clear disclaimer" that the reduction or elimination was not guaranteed, when in fact no such disclaimer exists;

(c) the court abused its discretion under Rule 23 by holding that the time and cost involved in determining the identities of subclass members (i.e.,

which policyholders received a pre-sale illustration) from LSW's files was a sufficient reason alone to decertify the subclass; the court failed to consider the inconvenience under the manageability component of Rule 23(b)(3)'s superiority requirement.

3. In regard to Plaintiffs' volatility and tax defect claims on behalf of the class:

(a) the court abused its discretion to the severe prejudice of Plaintiffs by excluding the most probative evidence of intent under Federal Rule of Evidence 403, including evidence that LSW internally projected that very few policyholders would obtain the tax benefits. This evidence should not have been kept from the jurors, and certainly should have been admitted in the bench trial where there was no risk of prejudice or jury confusion;

(b) the court committed reversible error under the de novo standard (applicable to mixed questions of law and fact) when it concluded that LSW's illustration is not deceptive because it discloses that the S&P500 could perform better or worse than the illustrated historical average, ignoring Plaintiffs' claim that the illustration fails to disclose the risk that arises even if the S&P500 performs on average at the illustrated historical average;

(c) the court committed legal error in finding that the California Insurance Code affirmatively bars the use of Monte Carlo simulations to assist disclosure of the volatility and tax risks;

(d) the court relied on an impermissible legal criterion when it held that Plaintiffs had not provided sufficient class proof because they did not present a survey or prove a negative (that LSW or its agents did not make sufficient disclosures) even though the uniform evidence was that the risks were not disclosed.

ARGUMENT

I. The District Court Contravened California Supreme Court Precedent By Barring Plaintiffs' UCL Claims Predicated On The California Insurance Code

Plaintiffs' complaint asserted claims under the unlawful and unfair prongs of the UCL based on allegations that LSW's illustration violates numerous specific provisions of the California Insurance Code, Section 10509.950, et seq.[7] The court

[7] Plaintiffs advanced a number of claims based on violations of the California Insurance Code. For example, Section 10509.955(b)(3) states that an insurer may not "[s]tate or imply that the payment or amount of nonguaranteed elements is guaranteed." LSW violates this provision by misrepresenting LSW's actual guaranteed interest rate and also by stating or implying that the Monthly Administrative Charge will be reduced or eliminated beginning in the eleventh year. ER464-13 ¶¶18-23 & ¶ 95(c)-(n). Section 10509.956(e)(3) also requires that "Nonguaranteed elements may be shown if described in the contract," but although the values in the illustration include the following nonguaranteed elements, LSW does not describe them in the contract: the reduced or eliminated Monthly Administrative Charge, Paragon's eliminated Percent of Accumulated Value

granted LSW's motion to dismiss the unlawfulness claims and granted its motion for judgment on the pleadings to dismiss the unfairness claims. ER59 & ER112. In doing so, the court followed its previous erroneous ruling in an earlier case against LSW (the *Krall* case, ER35-8) and held that Section 10509.950, et seq., cannot give rise to UCL claims because *Moradi-Shalal v. Fireman's Fund Ins. Co.*, 46 Cal. 3d 287 (1988) establishes that UCL unlawfulness claims can be based only on statutes that provide a private right of action. ER35-8. The plaintiff in *Krall* did not oppose LSW's motion on this issue, but the court followed *Krall* even when Plaintiffs in the present case pointed out contrary controlling authority from the California Supreme Court and this Court. The court later compounded this error by refusing to reconsider its decision and provide Plaintiffs with leave to amend in light of the California Supreme Court's intervening decisions in *Rose v. Bank of Am.,* 57 Cal. 4th 390 (2013) and *Zhang v. Superior Court,* 57 Cal. 4th 364 (2013). ER461 & ER478.

This Court should reverse under its de novo standard of review because the very purpose of the unlawful prong of the UCL is to "borrow[] violations of other laws and treat[] them as unlawful practices that the unfair competition law makes independently actionable." *Cel-Tech Communications, Inc., v. Los Angeles*

Charge (a nonguaranteed elimination of a charge in the eleventh policy year), and Provider's Account Value Enhancement (a nonguaranteed bonus that increases the illustrated policy values beginning in the eleventh policy year). *Id*.

Cellular Tel. Co., 20 Cal. 4th 163, 180 (1999) (internal quotation omitted). Whether the Code itself provides for a private cause of action "is immaterial" because, as the California Supreme Court has "long recognized, it is in enacting the UCL itself, and not by virtue of particular predicate statutes, that the Legislature has conferred upon private plaintiffs specific power to prosecute unfair competition claims." *Stop Youth Addiction, Inc. v. Lucky Stores, Inc.*, 17 Cal. 4th 553, 562-67 (1998) (internal citation and quotation omitted). The only exception to this broad use of the unlawful prong is where a separate principle of law provides an "absolute bar to relief." *Cel-Tech*, 20 Cal. 4th at 182.

This Court has applied the same actual bar test as the California Supreme Court, holding that "section 17200 can form the basis for a private cause of action even if the predicate statute does not." *Chabner v. United of Omaha Life Ins. Co.*, 225 F. 3d 1042, 1048 (9th Cir. 2000). The only limitation is that a plaintiff is not permitted to "plead around an absolute bar to relief simply by recasting the cause of action as one for unfair competition." *Id.* (quoting *Cel-Tech*, 20 Cal. 4th at 182); *Stop Youth Addiction*, 17 Cal. 4th at 562-67. In the words of this Court, "[t]his limit is rather narrow, however. 'To forestall an action under [section 17200], another provision must actually 'bar' the action or clearly permit the conduct.'" *Id.* (quoting *Cel-Tech*, 20 Cal. 4th at 182).

The district court acknowledged that *Stop Youth Addiction* and *Chabner* were "some of the formative cases," but nonetheless dismissed Plaintiffs' claims because "[a]s the Court explained in its earlier order in Krall, there is no private right of action under California Insurance Code section 10509." ER59 at 9. Without further explication, the court stated that it was "not convinced" that *Cel-Tech*, *Stop Youth Addiction*, *Chabner*, and other cited cases "support Plaintiffs' argument." *Id*. The court later extended its ruling to bar Plaintiffs' use of the statute as the predicate for unfairness claims, again relying on "the Krall case decision" and citing a decision that barred an attempt to plead around *Moradi-Shalal* (*Textron Financial Corp. v. National Union Fire Ins. Co. of Pittsburgh*, 118 Cal. App. 4th 1061, 1070 (2004)).[8]

The court erred because Plaintiffs' claims are not barred by *Moradi-Shalal*, which reconsidered and abolished a third party statutory bad faith cause of action under the Unfair Insurance Practices Act, Cal. Ins. Code §790 et seq. (the "UIPA"). *Zhang,* 57 Cal. 4th at 372-73. *Moradi-Shalal* was concerned with the "numerous adverse consequences of third party bad faith claims, including

[8] The court's holding that Plaintiffs could not predicate their unfairness claim on Section 10509.950, et seq. led it to an incorrect conclusion in later finding that Plaintiffs' unfairness claims failed because they were not "tethered to a legislatively-declared public policy." ER791 at 70. Plaintiffs' claims plainly are tethered to the public policy in Section 10509.950, et seq., but the court apparently ignored that fact because it had earlier ruled that the statute could not serve as a predicate statute for a UCL violation.

proliferating litigation, unwarranted settlement demands, escalating insurance costs, conflicts of interest, practical difficulties with the scope and nature of the third party cause of action, and potential constitutional issues." *Id*. at 381-82. Some later cases, such as *Textron*, extended the *Moradi-Shalal* rule to further hold that "parties cannot plead around Moradi-Shalal's holding by merely relabeling their cause of action as one for unfair competition." ER112 at 9 (citing *Textron*).

Plaintiffs' claims are not subject to *Moradi-Shalal* because they are predicated on Section 10509.950, et seq., not the UIPA; Plaintiffs also seek equitable relief, not damages as in *Moradi-Shalal*. *Chabner* is on-point that *Moradi-Shalal* does not apply where claims are brought under a section of the Insurance Code other than the UIPA (in that case, Section 10144), even if those claims might also give rise to UIPA liability. *Chabner*, 255 F. 3d at 1049-50. The district court's decision also conflicts with *Rand v. Am. Nat'l Ins. Co.*, 2009 U.S. Dist. LEXIS 64781 (N.D. Cal. July 28, 2009), which rejected the application of *Moradi-Shalal* and permitted UCL claims predicated on Section 10509.950. And the court's rationale is inconsistent with numerous decisions that reject *Moradi-Shalal* where the alleged Code violation did not amount to an attempt to bring a third-party bad faith claim under the UIPA.[9]

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[9] *Hughes v. Progressive Direct Ins. Co.*, 196 Cal. App. 4th 754, 767-70 (2011) (Ins. Code §758.5); *Troyk v. Farmers Group, Inc. v. Prematic Serv. Corp.*, 171 Cal. App. 4th 1305 (2009) (Ins. Code §381); *Pastoria v. Nationwide Ins.*, 112 Cal.

After the district court's initial decisions, the California Supreme Court's rulings in *Rose* and *Zhang* made it even clearer that Plaintiffs' claims are not barred by *Moradi-Shalal*. ER461 & ER478. These decisions hold that (1) "a UCL action is not precluded 'merely because some other statute on the subject does not, itself, provide for the action or prohibit the challenged conduct;'" instead, the predicate statute must "actually 'bar' the action," *Rose,* 57 Cal. 4th at 398; and (2) even though "[p]rivate UIPA actions are absolutely barred," a UCL action is nonetheless permitted "when insurers engage in conduct that violates both the UIPA and the obligations imposed by other statutes or the common law." *Zhang*, 57 Cal. 4th at 384. In respect to the second holding, *Zhang* explicitly "disapprove[d] *Textron*," the primary decision on which the district court relied. *Zhang*, 57 Cal. 4th at 379-83; ER112 at 9.

The court refused to reconsider its decision in light of *Rose* and *Zhang*, however, incorrectly asserting that *Zhang* "unequivocally" holds that a UCL claim is barred "where the legislature does not create a private right of action and instead opts for administrative enforcement by a government entity." ER478 at 4 & n. 3. The court concluded that Plaintiffs cannot predicate a UCL claim on the statute

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App. 4th 1490 (2003) (Ins. Code §§330-34 and 381); *Cedars-Sinai Med. Ctr. v. United Healthcare Ins. Co.*, 2010 U.S. Dist. LEXIS 55150, *14-16 (C.D. Cal. May 7, 2010) (Ins. Code §10192.6(a)); *Williams v. Prudential Ins. Co.*, 2010 U.S. Dist. LEXIS 14566 (N.D. Cal. Feb. 2, 2010) (Cal. Code. Reg. Section 10, sub. 2695.3).

because "administrative enforcement the by [sic] the Insurance Commissioner is contemplated." ER478 n. 3.

The court erred because, as the California Supreme Court reaffirmed in *Zhang*, "a cause of action neither barred by *Moradi-Shalal* nor absolutely precluded by other law may serve as the basis for a UCL claim." *Zhang*, 57 Cal. 4th at 381. That the Legislature contemplated administrative enforcement of Section 10509.950, et seq. is irrelevant because a UCL claim predicated on the statute is neither barred by *Moradi-Shalal* nor absolutely precluded by another law.

Moreover, the court's rationale was expressly rejected in *Hughes v. Progressive Direct Ins. Co.*, 196 Cal. App. 4th 754, 767-70 (2011), which held that the lack of a private cause of action and the sole contemplation of administrative enforcement of a different Insurance Code section (758.5) did not bar a UCL claim. *Hughes* explained that the lack of a "private right of action" and a grant of authority to the Insurance Commissioner to "enforce the section in the same manner . . . as UIPA violations" is "not enough to constitute an 'express' repeal of the cumulative remedies made available by the Legislature under the UCL or to transform section 758.5 into simply another unlawful practice under the UIPA." *Id*. at 767-68; Cal. Bus. & Prof. Code §17205 ("Unless otherwise expressly provided, the remedies or penalties provided by this chapter are cumulative to each other and to the remedies or penalties available under all other laws of this state.").

Thus, the district court erred in dismissing Plaintiffs' UCL claims on the grounds that Section 10509.950, et seq., lacks a private cause of action.

II. Plaintiffs' Bait And Switch Claims

A. The Court's Decisions On Policy Fees And Guaranteed Interest Contravened *Chern v. Bank of America*

Plaintiffs tried individual claims under all three prongs of the UCL pursuant to *Chern v. Bank of Am.*, 15 Cal. 3d 866 (1976), in which the California Supreme Court held that the UCL prohibits "bait and switch" schemes where defendants initially mislead a consumer and then attempt to use subsequent disclosures to provide a shield against liability.

The named plaintiffs here testified that they were baited by representations in the illustration that there is '***One Policy Fee***,' and disclosure in the illustration of only one fee (the Monthly Administrative Charge), while in fact the policy contains many significant fees (including a "Premium Expense Charge" of 5% or 6% of each dollar invested) that are not disclosed in the illustration. LSW also enticed the plaintiffs with representations in the illustration of "Guaranteed Values at 2%" (Provider) or "Guaranteed Values at 2.5%" (Paragon), and a chart of "Guaranteed Accumulated Values" that depicted returns based on that annual rate. However, LSW's actual retrospective averaging methodology is much less favorable than an annual guarantee. Indeed, it has virtually no value because historically the S&P500 has never performed under the amount of LSW's

guarantee when averaged over time. TX947; ER808 at 8:2-11:1; TX221; ER811 at 200:1-201:1; ER735-2 at 163:11-165:4.

The court held that these practices are not likely to deceive because there are "disclosures regarding the policy fees and charges in the relevant policies." ER791 at 71, 73.[10] The UCL prohibits representations that are likely to entice a consumer into negotiations, however, even where true disclosures are made before the consumer is obligated to purchase. *Chern*, 15 Cal. 3d at 876. Accurate contract language does not preclude UCL liability because the public is likely to be deceived by bait and switch schemes. *Id.*

In *Chern*, the plaintiff was baited with a 9% loan rate conveyed in a telephone conversation and was only informed that the rate was actually 9.25% when she applied for the loan at the bank. There was "uncontradicted evidence that plaintiff knew [the true facts] at the time she entered into the loan contract," *id.* at 873-74, but the California Supreme Court nonetheless held that the fact that the defendant "may ultimately disclose the [truth] does not excuse defendant's practice of quoting a lower rate in its initial dealings with potential customers." *Id.* at 876. The court reasoned that "the original [deception] may unfairly entice persons to commence [] negotiations with defendant in the expectation of obtaining that

[10] The named plaintiffs all received their policies months after they received their illustrations. TX4, 30, 48, 888; ER809 at 88:9-89:13, 92:21-24, 215:4-20; ER810 at 15:11-18:3; ER808 at 80:6-10, 88:15-89:1.

[originally represented product].” *Id*. at 876. It concluded that “Defendant offers no sound reason why it could not quote an accurate annual rate during its initial communication with its customers, rather than withhold such information until the customer has entered its premises.” *Id*. Similarly, LSW cannot withhold information about policy fees and the guaranteed minimum in its illustration and then rely on the customer to later ferret out the deception for themselves through the examination of other documents.[11]

Consistent with *Chern*, this Court has held that deceptive representations violate the UCL even where consumers are provided with unambiguous

[11] The court also suggested that the illustration was not deceptive because the policy values in the illustration are “net of fees,” but Elizabeth MacGowan of LSW admitted that “[i]t would be difficult to, as you say, reverse engineer” the illustration to figure out the amount of fees being charged. ER811 at 131:9-132:8. The court noted that LSW witnesses testified to benefits of showing the policy values net of fees, but Plaintiffs didn’t quarrel with illustrating policy values net of fees; Plaintiffs contended that the existence of the various types of fees and their amounts needed to be disclosed as separate items in the illustration because the illustration states that there is One Policy Fee, the only policy fee specified in the illustration is the amount of the Monthly Administrative Charge, and “[i]t would be difficult,” as MacGowan testified, to ascertain the other fees by just looking at the policy values. The court also asserted that because “the categories of fees charged by LSW are common among IUL products, the Court cannot conclude that the charges are inconsistent with the specific and particularized expectations of the targeted consumers.” But the court ignored Plaintiffs’ claim that the representation of One Policy Fee made the illustration deceptive because it led the named plaintiffs and any reasonable consumer to believe that all charges were encapsulated in that one fee. Moreover, the named plaintiffs testified that they were unaware of IUL products until encountering the LSW policies and the court’s speculation is dubious that a reasonable consumer should be expected to know the categories of fees charged by competitors of the defendant insurance company.

information that is contrary to the representation prior to sale. *Rubio v. Capital One Bank,* 613 F.3d 1195, 1204 (9th Cir. 2010) (credit card solicitation of a "fixed" annual percentage rate was likely to deceive consumers, notwithstanding unambiguous language of the actual cardholder agreement that directly contradicted the solicitation); *Williams v. Gerber Prods. Co.*, 552 F.3d 934, 938 (9th Cir. 2008) (representation of product as "Fruit Juice Snacks" violated the UCL despite an ingredient list that specifically showed that the product contained no juice from actual fruit).

The court's ruling that LSW's illustration is not likely to deceive because of disclosures in the policy is contrary to *Chern*. It is inconsistent with the court's own denial of LSW's motion to dismiss, in which it relied on *Chern* and *Williams* to conclude that "the UCL 'is far broader than common-law fraud in terms of the type of conduct that it prohibits', and that disclosures in the Policy would be insufficient 'to cure deception in the [I]llustration.'" ER59 at 11-12. The court did not explain the basis for its post-trial reversal on this question of law and did not discuss *Chern*.[12]

The court's conclusion that subsequent disclosures immunize LSW from liability for its deceptive illustration would undermine the public interest by

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[12] In regard to the minimum guarantee, the court also noted that the illustration states that the policy has a zero percent floor. The Guaranteed Values involve an independent product feature; the court did not cite any testimony that the floor was relevant to LSW's representations concerning the guarantee.

excluding all manner of bait and switch schemes from the UCL's scope. The UCL does not allow companies to "mislead consumers and then rely on the [later disclosures] to correct those misinterpretations and provide a shield for liability for the deception." *Williams*, 552 F.3d at 939.

B. The Court Erred In Holding That LSW's Depiction Of The Monthly Administrative Charge Was Not Deceptive

Plaintiffs also brought a third bait and switch claim, contending that the illustration deceptively depicts a reduced or eliminated Monthly Administrative Charge in later years, but does not disclose that it is not guaranteed. Unlike Plaintiffs' other bait and switch claims, the court did not find that there were sufficient disclosures in the policy because the policy itself also fails to disclose that the reduction or elimination is not guaranteed.[13]

The court, however, made the clearly erroneous factual finding that the illustration was not likely to deceive because "Plaintiffs did not establish that the illustration eliminating the eleventh-year Monthly Administrative Charge depicted the elimination as a guaranteed value." ER791 at 74. But LSW uses an asterisk (*) throughout the illustration to denote any values that are not guaranteed. The asterisk (*) next to a particular value directs the reader to text at the bottom of each respective page that states: "* Benefits and values are not guaranteed." TX4.

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[13] In fact, the policy says nothing at all about the administrative charge reduction shown in the illustration, in violation of Insurance Code Section 10509.956(e)(3).

Since there is no asterisk (*) next to the Monthly Administrative Charge, no reasonable consumer would conclude that it is not guaranteed.

The court also stated that the illustration contains a "clear disclaimer [that] provides that the only items that are guaranteed are those clearly labeled as such," ER791 at 74, but this is clearly erroneous because there is no such disclaimer and the court did not cite anything in support of its assertion. Such a disclaimer would not be permissible in any event, as Insurance Code Section 10509.956(a)(7) states that any nonguaranteed elements shown in an illustration "shall be clearly labeled as such."

C. The Court Erred In Decertifying The Subclass

The court held that the time and cost involved in determining the identities of subclass members (i.e., which policyholders received pre-sale illustrations) from LSW's files was a sufficient reason alone to decertify, even though common issues of fact and law otherwise predominated. The court's ruling that this process necessitated decertification contravened recent decisions from the Sixth and Seventh Circuits, which hold that concerns about administrative inconvenience in identifying class members must be addressed under the rubric of 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).

1. 72% Of The Class Can Be Identified From LSW's Files

A statistically significant sample of LSW's policyholder files established that use of a pre-sale illustration, and thus subclass membership, was shown for 72% of the class. ER420-15 at ¶9. The court held that any of the following documents could establish subclass membership:

1. 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 at 31-32.[14]

2. An Agent's Report "also establishes subclass membership," where it contains a notation that an illustration was used. *Id.* at 31-32 & n.16; or

3. An illustration with a print date that predates the date of application "would establish [sub]class membership" if it was signed by the applicant "on a date that pre-dates the Policy issuance." *Id.* at 33 & n.18.2

In granting certification, the court approved a file review by "a court-appointed Special Master or a class administrator" and held that "[o]f the remaining approximately one-third of the members of the class, their subclass

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[14] The court's order stated that if the box is checked, that is an indication that an illustration matching the policy was provided to the applicant (ER353 at 32), but the parties agreed that this was a typographical error that did not affect the analysis. ER408-1 at 18:15-17 & n.13.

membership could be ascertained by the use of a questionnaire." *Id*. at 33. When LSW contended that a special master needed to be appointed to ascertain the identities of subclass members *prior* to class notice, and contended that the "file review would be an overwhelming task," the court issued an order to show cause why the subclass should not be decertified. ER417 at 2.

Plaintiffs submitted formal bids from several highly experienced computer services companies (Kroll Ontrack, BIA, and Class Action Administration), which showed that the subclass membership data could be extracted and summarized in less than 5 weeks for about $4 per subclass member ($167,179, a cost that Plaintiffs offered to pay)). ER420-1 ¶¶5-8. The $4 cost of the review is small compared to the average potential damages. ER353 at 26.

The court nonetheless speculated that it would "likely be called upon to determine hundreds of individual issues regarding subclass membership." ER447 at 4. But there is no record evidence, and none cited in the decision, to support this statement. LSW raised no genuine disputes in regard to any files in the 800-policyholder sample. LSW attempted to cherry-pick 13 possibly problematic files out of 44,000, but, in all but one case, one or more of the pertinent documents clearly established subclass membership.[15] Even the court's order acknowledged

[15] In one case, there was no evidence bearing on subclass membership and no basis for any dispute. ER450 at 15:11-16; ER436, 436-1, & 436-2. Under the court's original order, this policyholder would be sent a questionnaire.

that LSW failed to identify any conflicts. ER447 at 4 ("[A]s the Court understands the inference, there would be no controversy regarding subclass membership. That may be so.").

2. The Court Applied An Improper Legal Standard By Failing To Consider Administrative Inconvenience As A Manageability Issue

The only individual question the court identified was the need to determine whether each policyholder is a member of the subclass. Although the court correctly noted in granting certification that the question of subclass membership "tends to resemble more a manageability issue," *see* ER353 at 35 n. 21, it failed to analyze the issue as one of manageability in decertifying. This is reversible error because the court failed to weigh the purported administrative inconvenience of identifying subclass members against the benefits of certification. *Mullins*, 795 F.3d at 663-65.

In *Mullins*, the Seventh Circuit rejected a "stringent version of ascertainability" that was adopted by the Third Circuit in *Carrera v. Bayer Corp.*, 727 F.3d 300 (3d Cir. 2013). The stringent version of ascertainability requires "the easy identification of class members" and is aimed at "ensuring that the court will be able to identify class members without 'extensive and individualized fact-finding or mini-trials.'" *Mullins*, 795 F. 3d at 663. The Seventh Circuit held that "[t]his concern about administrative inconvenience is better addressed by the

explicit requirements of Rule 23(b)(3);" namely, by considering "the likely difficulties in managing a class action" as part of determining whether class treatment is "superior to other available methods for fairly and efficiently adjudicating the controversy." *Id*.

The Seventh Circuit reasoned that considering administrative inconvenience under another requirement of Rule 23 "renders the manageability criterion of the superiority requirement superfluous." *Id*. 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*.

The Seventh Circuit concluded that an adverse consequence of failing to address administrative inconvenience under the rubric of manageability is that "courts will err systematically against certification." *Id*. at 664-65 (citing Geoffrey C. Shaw, Note, *Class Ascertainability*, 124 Yale L.J. 2354, 2396-99 (2015)). This is because "when courts approach the issue as part of a careful application of Rule 23(b)(3)'s superiority standard, they must recognize both the costs *and benefits* of the class device." *Id*. At 663-64 (citing 7AA Wright et al., *Federal Practice & Procedure* §1780 ("Viewing the potential administrative difficulties from a comparative perspective seems sound . . . In no event should the court use the possibility of becoming involved with the administration of a complex lawsuit as a justification for evading the responsibilities imposed by Rule 23.")). In many

instances where it is difficult to identify class members, "there realistically is no other alternative to class treatment" and, as a result, class treatment is superior to "other available methods" – "those Rule 23(b)(3) actions requiring the most management may yield the greatest pay-off in terms of effective dispute resolution." *Id*. at 644.

The Seventh Circuit's reasoning is consistent with that of the Sixth Circuit in *Young v. Nationwide Mut. Ins. Co*., 693 F.3d 532, 539-40 (6th Cir. 2012). *Young* involved the certification of subclasses with over fourteen million policyholders and flatly rejected defendants' contentions that the "large number of individual determinations in order to ascertain class membership" would render the subclasses unmanageable or defeat predominance. *Young*, 693 F.3d at 539 & n.2.

Young followed the decisions of "[s]everal other courts" in concluding that "the size of a potential class and the need to review individual files to identify its members are not reasons to deny class certification." *Id*. at 540. The Sixth Circuit "reject[ed] Defendants' attacks on administrative feasibility based on the number of insurance policies at issue":

> Equally – if not more – persuasive is the district court's practical rationale: '[T]he need to manually review files is not dispositive. If it were, defendants against whom claims of wrongful conduct have been made could escape class-wide review due solely to the size of their businesses or the manner in which their business records were maintained.' We find this reasoning compelling."

Id. at 540.

The district court in granting certification noted that its decision was in "accord" with *Young's* holding that an "extensive review of a defendant's files to ascertain class membership should not preclude class certification." ER353 at 34 n. 20. But, ignoring the centrality of the superiority analysis in its decertification order, the district court held that "individualized issues created by a review of 42,000 files predominate" because "the common legal and factual issues for the subclass are by comparison quite simple." ER447 at 5. The court erred by simply comparing the time it expected to expend addressing the individual versus the common issues, instead of comparing the administrative inconvenience of determining class membership to the efficiencies gained in class treatment. *Mullins*, 795 F.3d at 663-65 ("Under this comparative framework, refusing to certify on manageability grounds alone should be the last resort."); *Carnegie v. Household Int'l, Inc.*, 376 F.3d 656 (7th Cir. 2004). In granting certification, the court correctly held that "a class action is clearly the most efficient and in all likelihood the most equitable method for resolving the parties' dispute" because the "logistical difficulties" in "adjudicating tens of thousands of claims . . . must be compared to the alternative method of adjudicating the parties' claims: that is, thousands of actions by individual class members." ER353 at 27 (internal citations omitted). It was legal error for the court to reverse course.

III. Plaintiffs' Volatility And Tax Defect Claims

A. The Court Incorrectly Excluded Key Evidence From Both The Jury Trial And The UCL Proceeding

The court's exclusion under Rule 403 of three types of evidence severely prejudiced Plaintiffs' attempts to demonstrate LSW's wrongful intent, which was the central disputed issue in the jury trial on the volatility and tax defect claims. While the "district court's Rule 403 determination is subject to great deference," *United States v. Hinkson*, 585 F.3d 1247, 1267 (9th Cir. 2009) (*en banc*), the evidence was highly probative and the court's concerns were unfounded.

The court's exclusion of the evidence under Rule 403 is all the more inexplicable with regard to the court's consideration of the UCL claims because "Rule 403 is inapplicable to bench trials." *United States v. Preston*, 706 F.3d 1106, 1117-18 (9th Cir. 2013). The court held that consideration of the evidence would constitute an "undue consumption of time," ER778 at 2, but introduction of much of the evidence did not require live testimony, the court had placed the parties on strict time limits, and the admission of the evidence would not have resulted in significant delay. *Cf. Shad v. Dean Witter Reynolds, Inc.*, 799 F.2d 525, 530 (1986); *Poling v. Morgan*, 829 F.2d 882, 888 (9th Cir. 1987).

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

The court abused its discretion by excluding evidence that at the time LSW designed the policies, it projected that 93.8% (Provider) and 90.2% (Paragon)

would no longer be in force at the time of the insured person's death because their policy would lapse or be surrendered prior to that point. ER674 at 20-21; ER514, 514-1 at LSW00037137, ER514-2 at LSW00017552, ER514-3 at LSW00036876 & LSW00036882. Exclusion of this evidence was highly prejudicial because fraudulent intent and liability were sharply contested, as is common in complex financial fraud cases. LSW's internal projections were critical evidence bearing on its intent and demonstrated that, although LSW sells the policies with a tax-free retirement marketing strategy, LSW expected that fewer than 10% of policyholders would ever obtain tax benefits.

The court previously rejected LSW's arguments that this evidence should be excluded and specifically relied on this evidence in granting class certification (ER353 at 3-4), but it subsequently reversed itself on the eve of trial on the grounds that the relevance of the evidence was outweighed by its prejudice. The court reasoned that the 93.8% and 90.2% figures included projections of policyholders who either lapsed or surrendered, and policy surrender was purportedly "not the basis of [Plaintiffs'] claims." ER674 at 20.

The court was wrong for two reasons. First, although the projections include policies that terminate by surrender as well as lapse, both policy terminations are relevant and expressly pled in Plaintiffs' complaint. For Plaintiffs' tax claim, there is no distinction between surrenders and lapses because in both situations the

policyholder cannot obtain any tax benefits. ER205 ¶6. Moreover, Plaintiffs alleged that surrender was the rational result for policyholders, such as Spooner and Walker, who came to realize the high fees of the policies and surrendered in order to salvage what value was left in their policies. *Id.* ¶ 46, 58, 68.

Second, even if the court were correct to exclude the combined lapse/surrender statistic, it erred by prohibiting testimony and evidence that was *solely* about lapse rates. Plaintiffs proposed to remove surrenders from the combined lapse/surrender projections to determine the amount of lapses that LSW projected, but the court would not allow it. ER681 at 3, 8-11; ER681-1 to 681-6; TX99 & TX131; ER804 at 227 & 239-41. Plaintiffs' expert was available to provide this testimony, which was supported by a comprehensive study of the life insurance industry from 2000-2010 (which demonstrated that lapses are 80.3% to 86.5% of lapse/surrender statistics), LSW's own experience across its life insurance business (in which lapses were between 89.6% and 93.5% of lapse/surrender statistics) and LSW's actual experience with the Provider and Paragon policies (in which lapses are 82.6% of lapses and surrenders combined). *Id*. Based on this evidence, Plaintiffs' expert removed the surrenders from LSW's projections, isolated the number of pure lapses that LSW projected, and was prepared to testify that LSW projected pure lapse rates of 75.04% and 72.16% for the policies. *Id*. But the court inexplicably characterized Plaintiffs' attempt to

offer this testimony as a "motion for reconsideration" of its prior decision, and flatly stated that its ruling would "stand," even though the earlier ruling only concerned surrenders and provided no grounds for excluding evidence that pertained solely to lapse projections. ER804 at 227. The court also refused to allow evidence from LSW's files and witnesses that would isolate the lapse percentage. ER810 at 235-39; TX584 & TX584R; ER681-1 to 681-6 & ER802 at 15-16. The court's rulings were an abuse of discretion and prejudiced Plaintiffs by depriving them of some of the most probative evidence of LSW's intent and liability.

2. LSW's Statement That Its Illustration Is A "Hallucination"

The court also abused its discretion in excluding the following email (TX34) that was shared among a number of LSW employees, including those in LSW's Market Conduct and Compliance Division:

> It seems to me that any illustration of non-guaranteed elements of a life insurance contract is a hallucination. That's why VUL was so hot 7 years ago, and why IUL is hot today. People want to believe the illustrated values. It seems to me that it's just a matter of strong disclosures. If we work too hard to protect customers from stumbling and falling, our competitors will be only too happy to give them the opportunity.

The exclusion of this damning email prejudiced Plaintiffs because it is highly relevant to LSW's state of mind and understanding that the non-guaranteed elements of IUL illustration are material and not realistic. ER700. The court stated that there would be "undue consumption of time . . . given tangential

probative value, given that it's not related to the insurance vehicles at issue here," but the email explicitly includes "any" IUL illustration. It is highly relevant because Plaintiffs' core theory is that the illustrations deceive consumers because they present non-guaranteed values based on a look-back method that masks the risks that arise from volatility. This internal email validated Plaintiffs' theory by explaining that the non-guaranteed values are a "hallucination" and that LSW doesn't provide truthful disclosures because of a fear of losing business.

3. Evidence That LSW Was Aware Of The Volatility Defect, And Familiar With Monte Carlo Simulations

The court also abused its discretion by excluding a presentation made by Richard Weber (TX326 (DVD), TX505-07 (presentation), & TX548 (transcript)) at the LSW "summer camp" attended by LSW agents and employees. ER700; ER805 at 5:2-8. Mr. Weber explains the use of Monte Carlo simulations for IUL illustrations, including that Monte Carlo software for IUL is available on the Internet to all members of the National Society of Financial Service Professionals.

Plaintiffs were prejudiced by the exclusion because LSW contended that Monte Carlos are not feasible and that plaintiffs' expert was just advancing an academic theory about the benefits of Monte Carlo simulations, but Mr. Weber's presentation shows that LSW knew that the opposite was true. TX548. The video also shows that LSW knew that, as Mr. Weber states, its "policies cannot possibly

succeed" as illustrated (TX548 at 45:1-2); because the illustration assumes no volatility, they present an "attractive impossibility." *Id.* at 25:6-27:4.

The court also abused its discretion in excluding Exhibits 62, 398, 415 and 417, which show that the same employees who operate LSW's IUL business use Monte Carlo simulations with financial products sold by an LSW affiliate. ER700; ER805 at 5:2-8. These exhibits explain many of the advantages of "Monte Carlo Analysis," including the ability to "approximate actual investment market volatility." TX415 at LSW-E00050049 & 51; TX62 at LSW-E00049994. The fact that Monte Carlo Analysis was approved by LSW for use with investment products that are based on the performance of a financial index, but not for IUL products that are based on the performance of a financial index, was a reason to allow the evidence, not to deny its use.

B. The Court Committed Reversible Error In Finding That LSW's Nondisclosure Of The Volatility And Tax Risks Does Not Violate the UCL[16]

1. The Court Avoided Addressing Plaintiffs' Core Theory In Holding That LSW's Existing Disclosures Are Adequate

The essence of Plaintiffs' volatility theory is easily understood by reference to the illustrations. Spooner's illustration, for example, depicts her paying $59,500

[16] Because the court based its rejection of plaintiffs' tax claim on its rejection of the related volatility claim, we refer solely to the volatility claims unless clarity requires otherwise. The court's determination that the disclosures are adequate is best characterized as a mixed question of law and fact, which is subject to a de novo review.

in premiums in each of the first four years. It then depicts her taking annual income of $79,995 beginning when she is 72 and continuing until she is 91, at which point she would still have a cash surrender value of $114,165. TX4 at LSW00001997-98. The illustration eliminates any volatility by using a "lookback" method that averages historical S&P500 returns to determine an average annual rate of return that is applied in each and every year. TX4 at LSW00001994; ER805 at 169:25-170:17. Because the illustration assumes that the S&P500 returns the same constant rate in each and every year going forward, the illustration depicts no risk of lapse if the scheduled premiums are paid. ER810 at 167:23-168:5; ER805 at 174:20-175:8.

The illustration ignores that the S&P500 is volatile. ER805 at 122:16-123:4, 177:9-178:8; ER810 at 167:18-22; ER807 at 162:23-163:7; 164:1-165:3. The impact of volatility can be measured through Monte Carlo simulations, which show that there is a 64% likelihood that the policy would lapse by Spooner's life expectancy of 87 years (with that probability increasing each year after that) if she made all the same premium payments and loans shown in the illustration.[17] ER806

[17] As Dr. Brockett testified, financial planners recommend using a longer time horizon than life expectancy (the median life span of a person with the same age and gender). Few prudent people would plan to have sufficient resources to live only to life expectancy given that they have a 50% chance of living longer. ER807 at 176:6-177:8.

at 24:3-25:16. Howlett similarly had a 58% chance and Walker a 61% chance of lapse by life expectancy. ER806 at 25:17-26:12.

Plaintiffs also presented evidence – uncontroverted by LSW – that the expected value of the cash flows produced by the policy were overwhelmingly likely to be lower in the real world with volatility as compared to the cash flows in the illustration. For example, considering 10,000 Monte Carlo simulations based on Ms. Spooner's illustration, the present value of the policy's cash flows was lower than depicted in the illustration in 80% of simulations. ER806 at 16:1-17:12. With respect to the class, there was a 95% (Provider) and 90% (Paragon) chance that the policy would have a lower value. ER806 at 20:15-21:5, 22:5-15.

The court held, however, that Dr. Brockett's calculations were inadmissible and of no probative value because he failed to offer "any testimony about the lapse rates or reduced policy values of any other insurance policies." ER791 at 50:9-10; *id*. at 46:16-18. This missed the point. Plaintiffs claimed LSW's policies were subject to undisclosed volatility risk, not that they were more risky than competitors' policies.

The court similarly avoided the thrust of Plaintiffs' theory in concluding that the following disclosures were adequate:

> This illustration assumes that the currently illustrated nonguaranteed elements will continue unchanged for all years shown. This is not likely to occur and actual results may be more or less favorable than those shown.

> The historical performance of the S&P500® index should not be considered a representation of past or future performance for any of the index strategies available in this policy, nor is it an estimate of the returns that a policyholder can expect based on the current caps and participation rates. The future yield performance for any of these strategies may be less than or greater than the non-guaranteed assumed interest rates used in this illustration.
>
> I have received a copy of this illustration and understand that any non-guaranteed elements illustrated are subject to change and could be either higher or lower. The agent has told me they are not guaranteed. I UNDERSTAND THAT HISTORICAL PERFORMANCE OF THE S&P500® INDEX SHOULD NOT BE CONSIDERED A REPRESENTATION OF THE PAST OR FUTURE PERFORMANCE FOR ANY OF THE INDEXED STRATEGIES.

ER791 at 61:9-62:16.

None of these disclosures inform the policyholder that volatility itself (as opposed to the average level of returns) has an effect on policy performance, let alone that the illustrated values "understate the level of risk inherent in the product." ER791 at 63:4-7. The court committed reversible error by concluding that these disclosures adequately inform consumers of the volatility risk.

2. The Court Committed Legal Error In Ruling That Disclosure Of Information Derived From Monte Carlo Simulations Was Prohibited By The Insurance Code

The court misapplied the law in holding that "LSW was under no duty to disclose . . . because depicting S&P volatility based on historical performance would require assumption of a rate during some years that would exceed the

maximum policy rate, an assumption that may not appear in an illustration governed by California law." ER791 at 57:7-24

The court cited two provisions of the Insurance Code. First, it held that disclosure of lapse or reduced value statistics is prohibited because the regulation prohibits the illustration of any "non-guaranteed elements" that are "based on a scale more favorable to the policy owner than the insurer's illustrated scale." Ins. Code §10509.956(a)(7). But lapse and reduced value statistics are not "elements" of an insurance policy. The Code defines "non-guaranteed elements" as "the premiums, benefits, values, credits or charges under a policy of life insurance that are not guaranteed or not determined at issue." Ins. Code §10509.953(m). A statistical probability of lapse (e.g., a 60% probability of lapse before life expectancy) or reduced value (e.g., the expected value of the policy is 30% less than shown in the illustration) is not a "premium, benefit, value, credit or charge," so it is not an "element" within the meaning of the Code.

Second, the court held that Plaintiffs' proposed disclosures were barred by Section 10509.955(b)(5), which prohibits an insurer from using "an illustration that at any policy duration depicts policy performance more favorable to the policy owner than that produced by the illustrated scale of the insurer whose policy is being illustrated." Ins. Code §10509.955(b)(5). The court's construction of the statute is unsupported by its text. Since a lapse or reduced value statistic does not

"depict[] policy performance [that is] more favorable" at any particular "policy duration," the prohibition is inapplicable. Moreover, returns in excess of the maximum illustrated rate may occur among some of the thousands of Monte Carlo simulations that generate the probability statistic, but do not occur for any "policy duration."

The court's construction of the statute also is contrary to its purpose "to protect consumers and foster consumer education." Ins. Code §10509.950. The court's interpretation immunized LSW for overstating policy performance based on provisions of the Code that directly prohibit overstating policy performance. It contravened the "intent of the Legislature in enacting this chapter to ensure that illustrations do not mislead purchasers of life insurance and to make illustrations more understandable." *Id.*

The court also failed to consider established legal principles under California law because it held that these two provisions precluded UCL liability, but the California Supreme Court has held that UCL liability is precluded by other statutes only if "the Legislature considered certain activity in certain circumstances and determined it to be lawful." *Cel-Tech*, 20 Cal. 4th at 183. Here, the Legislature did not consider the permissibility of disclosing lapse risk or reduced value statistics (i.e., certain activity) in connection with IUL illustrations (i.e., certain circumstances) because, as LSW's witnesses conceded, "the illustration regulation

was developed prior to the emergence in the marketplace of indexed universal life products" and "did not contemplate the possibility of a [IUL] product." ER820 at 144:5-21. LSW is not protected from UCL liability because "if the Legislature did not consider that activity in those circumstances, the failure to proscribe it in a specific provision does not prevent a judicial determination that it is unfair under the unfair competition law." *Cel-Tech*, 20 Cal. 4th at 183.

3. The Court Relied On An Impermissible Legal Criterion By Imposing Incorrect Requirements For Class Proof

The court's errors discussed above require reversal on the named plaintiffs' individual volatility and tax claims. As to the class claims, the court erred as a matter of law in holding that "in order to prevail on the classwide volatility claim, plaintiffs were required to prove that LSW uniformly failed to make [a volatility disclosure] to every class member." ER791 at 54:21-24. While the court acknowledged that it was imposing on plaintiffs "the difficult burden of proving a negative" (ER791 at 55:11-12), the burden it imposed was not simply difficult but impossible. The court ignored that the illustration software uniformly failed to disclose volatility risk and that an illustration was received by each and every class member (whether in both the pre-sale process and at delivery, or only at delivery); instead the court focused on the speculative possibility that an agent could have made a disclosure (even though the agents who testified all stated they were unaware of the volatility risk). ER791 at 49:13-50:3.

The court cited no authority that a plaintiff must negate the possibility of individual disclosure to a member of the class, and there is no such authority. Indeed, this Court has held that insurance policy illustrations can be used as a basis for proving an omission in a class case. *Yokoyama v. Midland Nat'l Life Ins. Co*., 594 F.3d 1087 (9th Cir. 2008).

Likewise, there was no support for the court's conclusion that plaintiffs were required "to establish the specific and particularized expectations of consumers regarding S&P performance on policy value or the risk of policy lapse" but failed to do so because plaintiffs "did not present any survey or other evidence from the class or its agents." ER791 at 59:13-16; *Clemens v. DaimlerChrysler Corp.,* 534 F.3d 1017, 1026 (9th Cir. 2008) (holding that surveys "are not required").

The court committed a clear error in concluding that Plaintiffs' illustration "sample is not fairly representative" because it "included only policies with sales illustrations, and the class includes a significant percentage of policyholders who did not receive sales illustrations." ER791 at 51:16-20.[18] LSW's illustration

[18] The court addressed testimony by Dr. Brockett concerning LSW's historical lapse rates, found that the testimony "considerably undermines Dr. Brockett's overall credibility," and that the court "therefore concludes that plaintiffs have offered no reliable or valid statistical evidence to establish the Paragon and Provider policies purchased by the class are prone to lapse." ER791 at 53:17-20. This conclusion does not affect plaintiffs' volatility claim for two reasons. First, the testimony had nothing to do with Dr. Brockett's Monte Carlo simulations and the lapse probabilities they provided, but was simply background evidence about LSW's actual historical lapse rates. ER807 at 11:1-12:13. Second, as noted above,

system uses the same software and disclosures regardless of whether the illustration is a "sales illustration" (provided before or at the time of application) or a "batch illustration" (provided at the time of policy delivery). ER806 at 39:6-40:8; ER807 at 213:25-214:15; ER802 at 106:19-22. The evidence was uncontroverted that the 280-illustration sample was a valid, random sample of sales illustrations. ER806 at 27:22-28:1; ER807 at 73:14-74:19; 182:1-11; 183:16-21, 214:16-216:20.

The court also rejected a subsample of 105 illustrations that depicted loans (like the named plaintiffs' illustrations). This subsample showed that the average probability that the policies would lapse before the insured's life expectancy was 59.8% (Provider) and 55.7% (Paragon). The court rejected the subsample because it did not include illustrations that did not depict loans, and the court questioned whether the subsample was "capable of being extrapolated to the entire class (or even some discernible subset of the class) to a reasonable degree of statistical certainty." ER791 at 51:24-52:2. This conclusion is clear error because Plaintiffs

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the court erroneously viewed the question of whether the policies were likely to lapse as being a question about whether they were more likely to lapse than other policies available in the market. ER791 at 50:5-20. As for whether the policies are "prone to lapse," the court employed an incorrect, and indeed meaningless, definition of whether policies are lapse-prone. The court stated that the policies were not "lapse-prone" because a policyholder could always pay sufficient premiums to ensure that the policy does not lapse. ER791 at 25:21-26:4. This ignores Plaintiffs' theory that the policies were lapse-prone relative to what LSW depicted in the illustration.

were using the subsample to demonstrate the lapse risk if the policy is used for retirement income. Illustrations that do not show loans are irrelevant to the policy's ability to provide retirement income because loans are the only way to derive tax-free income from the policy.

CONCLUSION

For the above reasons, this Court should reverse and remand as to both the fraud and UCL claims.

December 9, 2015 Kasowitz, Benson, Torres & Friedman LLP

By: /s/ *Brian P. Brosnahan*
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STATEMENT OF RELATED CASES PURSUANT TO CIRCUIT RULE 28-2.6

I certify that I know of no related cases pending which the Court might wish to consider with the instant appeal.

December 9, 2015 Kasowitz, Benson, Torres & Friedman LLP

By: /s/ *Brian P. Brosnahan*
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December 9, 2015 Kasowitz, Benson, Torres & Friedman LLP

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9th Circuit Case Number(s)	15-55809

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