No. 09-55513

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

FREEMAN INVESTMENTS, L.P.; DARREL FREEMAN IRREVOCABLE TRUST; FREEMAN JOINT IRREVOCABLE TRUST, individually and on behalf of a class of others similarly situated; DAVID KEMP, Trustee of the Darrel L. Freeman Irrevocable Trust, individually and on behalf of a class of others similarly situated; DAVID KEMP, Trustee of the Freeman Irrevocable Trust, individually, and on behalf of a class of others similarly situated,

Plaintiffs-Appellants,

v.

PACIFIC LIFE INSURANCE COMPANY,

Defendant-Appellee.

On Appeal From The United States District Court For The Central District Of California, No. 8:08-cv-01134-DOC-AN

Answer Brief of Defendant-Appellee Pacific Life Insurance Company

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CORPORATE DISCLOSURE STATEMENT
(Pursuant to Fed. R. App. P. 26.1)

Defendant-Appellee Pacific Life Insurance Company states that it is a Nebraska corporation, whose parent is Pacific LifeCorp, a Delaware Stock Holding Company, which owns 100% of the stock of Pacific Life. Pacific LifeCorp is a wholly owned subsidiary of Pacific Mutual Holding Company, a Nebraska mutual insurance holding company. No publicly held company owns 10% or more of these entities.

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JURISDICTIONAL STATEMENT

Plaintiffs' Class Action Complaint ("CAC"), First Amended Complaint ("FAC"), and Second Amended Complaint ("SAC") claimed subject matter jurisdiction based on 28 U.S.C. § 1332(a) (diversity) and (d)(2)(A) (the Class Action Fairness Act ("CAFA")).

Pacific Life agrees that the district court had subject matter jurisdiction based on CAFA. Pacific Life disagrees with Plaintiffs' contention that the action could have been maintained as an individual action under 28 U.S.C. § 1332(a). The complaint's individual claims do not appear to satisfy § 1332(a)'s $75,000 amount-in-controversy requirement.

The district court dismissed Plaintiffs' action on March 5, 2009. Final judgment was entered on April 1, 2009. Plaintiffs timely appealed on April 3, and this Court has jurisdiction under 28 U.S.C. § 1291.

COUNTER-STATEMENT OF THE ISSUE

Whether the Securities Litigation and Uniform Standards Act of 1998 ("SLUSA"), 15 U.S.C. §§ 77p(b), 78bb(f)(1), bars Plaintiffs from pursuing their state-law class action predicated on the sale of variable universal life insurance policies and the levying of undisclosed "hidden loads" in the "guise" of periodic charges for the "cost of insurance" against the accumulated cash value of the policies?

COUNTER-STATEMENT OF THE CASE AND FACTS

I. Overview Of Plaintiffs' Allegations And Class Action Claims

In their initial complaint and amended pleadings, Plaintiffs allege that Pacific Life has orchestrated a "deceitful" "scheme" to enrich itself at their expense by selling variable universal life insurance policies to them and charging undisclosed "hidden loads" in the "guise" of periodic charges for the "cost of insurance." ER 22-28 (SAC ¶¶ 8-10, 13, 15, 21-22, 26, 32, 34-37, 39-41, 43-45); 208-16 (CAC ¶¶ 7-9, 12-13, 15, 17-21, 32-33, 38, 41, 45 47, Prayer). According to Plaintiffs' pleadings, in written policies, quarterly statements, and other documents, Pacific Life "systematic[ally]" has misrepresented its "cost of insurance" charges and "concealed" the fact that these charges include amounts unrelated to the costs providing policyholders with life insurance protection. *Id.* Plaintiffs allege that, through this scheme, Pacific Life has "wrongfully diverted" funds from investments in registered securities and reduced the value of Plaintiffs' investments. *Id.*

Based on Pacific Life's alleged acts, practices, misstatements and omissions, Plaintiffs asserted state-law class action claims for monetary damages, and injunctive relief for breach of contract, breach of the duty of good faith and fair dealing, and violations of Cal. Bus. & Prof. Code § 17200. ER 22-28, 207-22.

II. Plaintiffs File A State-Law Class Action Complaint Containing All The Elements Necessary To Trigger SLUSA.

A. Plaintiffs Allege A State-Law Class Action For Damages Concerning Variable Universal Life Insurance Policies.

Plaintiffs' initial complaint asserted state-law class action claims for damages for breach of contract, breach of the duty of good faith and fair dealing, and violations of Cal. Bus. & Prof. Code § 17200 related to four variable universal life insurance policies allegedly purchased from Pacific Life. Specifically, Plaintiffs alleged that:

- Plaintiff Freeman Investments, LP purchased two variable universal life insurance policies funded by Pacific Life's "Pacific Select Exec II" separate account;
- Plaintiff the Darrel L. Freeman Irrevocable Trust purchased one variable universal life insurance policy funded by the "Pacific Select Exec II" separate account; and
- Plaintiff the Freeman Joint Irrevocable Trust purchased one variable universal life insurance policy funded by the "Pacific Select Estate Preserver V" separate account.

ER 208 (CAC ¶¶ 7, 10); Dkt. 4 (CAC Exhs. A-D) (copies of the Plaintiffs' policy documents); ER 31-203 (SAC Exhs. A-D) (same)).

The designated products are life insurance contracts that have both a variable death benefit and variable cash value. ER 31-203 (SAC Exhs. A-D) (same)). Under the terms of each policy, premiums paid by Plaintiffs are invested (net of any sales "loads" or other premium-based charges) in units of the Pacific Select Exec Separate Account (the "Separate Account"). *Id.*

The Policies further give each policyholder the option to choose from a number of "investment options,"—sub-accounts within the Pacific Select Exec Separate Account that correspond to mutual fund portfolios of the Pacific Select Fund. *Id.* Net premiums are applied to the purchase of units in the Separate Account, according to the particular investment options/sub-accounts chosen by the policyholder. *Id.*

Monthly charges, including the cost of insurance charges at issue in this litigation, are paid to Pacific Life through the sale and redemption of units of the Separate Account, "in proportion to the accumulated value [that a policyholder has in each option]." *See* Dkt. 23, Exh. B at 98 (Pacific Life "deduct[s] the monthly charge from the investment options that make up your policy's accumulated value, in proportion to the accumulated value you have in each option."). The death benefits and cash value of variable policies thus can vary depending on the performance of the particular mix of investment options/sub-accounts chosen.

Because Plaintiffs' variable life insurance policies allow a policyholder to "participate[] directly in the investment experience of the separate account and bear[] an investment risk [associated with that separate account]," each policy qualifies as a "security" for purposes of the Securities Act of 1933, 15 U.S.C. § 70a, et seq. *See* SEC Rel. No. 33-5360, 1973 WL 149307 (Jan. 31, 1973). Moreover, the Separate Account established to fund each policy and provide Plaintiffs with investment

options also meets the definition of an "investment company" set forth in the Investment Company Act of 1940, 15 U.S.C. § 80a-3(a)(1) and (a)(3). *Id.* Each policy thus is covered by a registration statement filed with the SEC and is issued with a prospectus that explains and discloses the features of the policy, the Separate Account, and the Separate Account's investment options.

Finally, in their policy applications, each Plaintiff expressly acknowledged receiving a prospectus covering their respective policies and investment options. *E.g.*, Dkt. 4, Exh. A (application, page 4); ER 66 (SAC, Exh. A) (same). The applications and prospectuses likewise confirm that Plaintiffs' policies are securities under the Securities Act of 1933 and that the Separate Account and mutual fund investment options associated with Plaintiffs' polices are investment companies registered under the Investment Company Act of 1940. Dkt. 23, Exhs. A-D (SEC registration statements and prospectuses concerning Plaintiffs' policies).

B. Plaintiffs Expressly Accuse Pacific Life Of Misrepresentations, Omissions, And "Deceitful Conduct" As Part Of A "Scheme" To Deduct "Cost Of Insurance" Charges Containing "Hidden Loads" That Allegedly Reduced The Value Of Their Investments.

Plaintiffs also alleged that Pacific Life issued policies to them "with specific written promises and representations regarding the pricing components of the policies." ER 208 (CAC ¶ 7). They additionally asserted

that their policies' fees and charges were supposed to be "transparent," and the cost of insurance charge in particular was supposed to be a "mortality" charge calculated based on an amount "necessary to meet the death benefits." ER 209-10 (CAC ¶¶ 8, 13).

However, according to Plaintiffs, in its written policies, quarterly statements, and other documents, Pacific Life purportedly failed to "identify" material information concerning the cost of providing life insurance protection, including Pacific Life's "*actual*" costs of insurance. ER 210 (CAC ¶ 15) (emphasis in original). Moreover, Plaintiffs maintained that Pacific Life "intentionally" and "systematic[ally]" "concealed expenses, overhead, and profit loads within cost of insurance charges." ER 209, 211 (CAC ¶¶ 9, 19). As Plaintiffs put it:

- Pacific Life's cost of insurance charges were "inaccurate" and not based on the cost of providing life insurance protection;
- Pacific Life had a "continuing duty to disclose" that its representations concerning its cost of insurance charges were inaccurate;
- Pacific Life "knowingly and actively concealed and denied the facts alleged herein," "misrepresenting" its cost of insurance charge and "concealing hidden loads" included in its cost of insurance charge;[1]

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[1] Plaintiffs alleged that these "hidden loads" were deducted from the premiums that each Plaintiff pays. ER 209, 214 215 (CAC ¶¶ 8-9, 19-21, 37, 41). A more detailed and precise description of the mechanics of the cost of insurance charge is found in the prospectuses given to each Plaintiff along with his policy. These documents establish that Plaintiffs' net premium

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- Pacific Life "kept" Plaintiffs, putative class members, and the general public in "ignorance of information essential to the pursuit of [Plaintiffs'] claims;" and
- Pacific Life was estopped from relying on any statute of limitations defense because of its "concealment of such material facts."

ER 209, 211, 213-15 (CAC ¶¶ 9, 19, 20, 32, 33, 41).

This "deceitful" conduct and "scheme" allegedly enabled Pacific Life to "generate undeserved revenues" for itself while levying "thousands" of dollars of excessive and improper cost of insurance charges against Plaintiffs, thereby reducing Plaintiffs' accumulated investment value.[2] ER 211 (CAC ¶¶ 19-22).

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payments are applied to the purchase of units in the Separate Account and that each month Pacific Life redeems units from the Separate Account to pay for the cost of insurance charge. *See* Dkt. 23, Exh. B at 98. The units, as noted above, are securities in the Pacific Select Exec Separate Account, an investment company registered under the Investment Company Act of 1940.

[2] While Plaintiffs allege that Pacific Life made misrepresentations and omissions concerning the basis of its "cost of insurance" charge, their pleadings do not actually quote the relevant language in Plaintiffs' policies defining the charge. Nor do they quote the disclosures that Pacific Life made in the prospectuses concerning the charge. *E.g.*, ER 89; Dkt. 23, Exh. B, at 98. The prospectuses make clear that Pacific Life "may profit from the cost of insurance charge and may use these profits for any lawful purpose, such as the payment of distribution and administrative expenses." Dkt. 23, Exh. B, at 98. The relevant portions of the policies and prospectuses state that the monthly "cost of insurance" charge will be equal to the product of
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Based on these alleged actions, practices, statements, and omissions, Plaintiffs asserted three state law causes of action for breach of contract, breach of the duties of good faith and fair dealing, and fraudulent, unfair, and deceptive business practices on behalf of themselves and a putative class of similarly situated policyholders. ER 214-16 (CAC ¶¶ 34-49, Prayer) (repeating allegations of "misrepresent[ation]" and "concealment" and "unfair and deceptive" business practices concerning "undisclosed loads" included within Pacific Life's cost of insurance charge).

III. Plaintiffs File First And Second Amended Class Action Complaints That Attack The Exact Same "Scheme," Involving The Same Insurance Products And Containing All The Elements Necessary To Trigger SLUSA.

After the filing of the initial complaint, as required by local rules, Pacific Life's counsel met and conferred with Plaintiffs' counsel and advised that Pacific Life intended to file a motion to dismiss because the action was barred by SLUSA. Plaintiffs responded by filing two amended pleadings.[3] The FAC and SAC attempted to: (1) excise references to

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the "Net Amount at Risk" under the policy and the "applicable monthly Cost of Insurance Rate" divided by 1,000. ER 89. The policies further specify that the monthly "Cost of Insurance Rates" will be determined by us [Pacific Life]," will "apply uniformly to all members of the same class," and "will not exceed certain guaranteed maximums." *Id.*

[3] After Plaintiffs filed the FAC, the Court, on its own initiative, raised certain questions regarding subject matter jurisdiction. The Court's
Continued on following page

misrepresentations or omissions by deleting terms like "misrepresentation," "concealment," "deceitful," and "deceptive;" (2) avoid express references to the extensive disclosures that Pacific Life made to Plaintiff in connection with the investments in their variable life insurance policies; and (3) limit Plaintiffs' claims to cost of insurance charges assessed "at or after the commencement of the policy term." ER 20-30 (SAC ¶¶ 1- 49).

Nevertheless, Plaintiffs continued to attack the same scheme related to their insurance products and the value of the investment accounts associated with them. These complaints included allegations that Pacific Life intentionally and systematically deducted the cost of insurance charges from the accumulated cash value of their policies that were "unrelated" to the actual cost of providing life insurance protection; that these charges were unlawful "hidden loads," "concealed" from Plaintiffs and other policyholders; and that these charges reduced the accumulated value of Plaintiffs' investments. ER 22-28 (SAC ¶¶ 8-10, 13, 15, 21-22, 26, 32, 36, 43, 45).

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observations prompted the filing of the SAC before any response to the FAC was due.

IV. Relying On SLUSA, The District Court Dismisses Plaintiffs' State-Law Class Action Claims.

On January 12, 2009, Pacific Life moved to dismiss Plaintiffs' SAC, arguing that the Plaintiffs' state-law class action claims were barred by SLUSA. Dkt. 22 (Notice and Motion). The district court agreed, granted Pacific Life's motion on March 4, 2009, and entered its judgment on April 1, 2009. ER 12-19. This appeal followed.

SUMMARY OF THE ARGUMENT

Plaintiffs maintain that SLUSA does not apply here because their state-law class action claims do not involve misrepresentations, omissions, or deceptive or manipulative conduct in connection with the purchase or sale of covered securities. Specifically, Plaintiffs contend that SLUSA does not apply because their SAC: (1) alleges a breach of contract claim that does not "depend" on allegations or proof of misrepresentations or omissions; and (2) does not allege that Plaintiffs made any investment decisions "in reliance" on a misrepresentation or omission. Here, however, SLUSA's application cannot be avoided for either reason.

To begin with, the text of the statute, controlling case law, and the statute's legislative history all establish that SLUSA is much broader than Plaintiffs assert and certainly broad enough to encompass their state law class allegations. Although ignored in Plaintiffs' briefing, these controlling

decisions unequivocally hold that SLUSA: (1) is not limited to state-law class action claims that "sound" in fraud or "depend" on allegations of misrepresentations or omissions; (2) does not require that a plaintiff allege that he or she personally made an investment decision to buy, sell, or hold any security in reliance on an alleged misrepresentation or omission; and (3) cannot be avoided by amending pleadings in order to disclaim any intention to rely on alleged misrepresentations or omissions.

In any event, despite their contentions, Plaintiffs do allege numerous misrepresentations and omissions in furtherance of an inherently deceptive scheme to deduct cost of insurance charges from the accumulated cash value of Plaintiffs' variable life insurance investments. Because these allegations "touch" on and "coincide" with investments in "covered securities," SLUSA precludes Plaintiffs' state-law class action claims. The district court's ruling to that effect accordingly should be affirmed.

Plaintiffs' alternate contention that they should have been given an opportunity to re-plead and file another complaint asserting only individual claims should be rejected as well. This issue was not preserved for appeal and is meritless in any event.

STANDARD OF REVIEW

This Court reviews de novo the dismissal of a plaintiff's action under Federal Rule of Civil Procedure 12(b)(6). *U.S. Mortgage, Inc. v. Saxton*, 494

F.3d 833, 841 (9th Cir. 2007); *Patenaude v. Equitable Life Assurance Society of the U.S.*, 290 F.3d 1020, 1025 (9th Cir. 2002). Under Rule 12(b)(6), a complaint should be dismissed for failure to "state a claim upon which relief can be granted." A complaint fails to state a claim if the complaint: (1) lacks a cognizable legal theory or (2) fails to allege sufficient facts to support a cognizable legal theory. *Robertson v. Dean Witter Reynolds, Inc.*, 749 F.2d 530, 533-34 (9th Cir. 1984).

In considering a motion to dismiss, courts generally do not look outside the pleadings. But a court may consider any document that is explicitly or implicitly "incorporated" into the complaint "by reference" (including prospectuses and other disclosure documents publicly filed with the SEC), as well as facts properly subject to judicial notice. *Knievel v. ESPN*, 393 F.3d 1068, 1076 (9th Cir. 2005); *Mack v. South Bay Beer Distributors, Inc.*, 798 F.2d 1279, 1282 (9th Cir. 1986).

More particularly, when considering a motion to dismiss under SLUSA, a court must carefully scrutinize the complaint's allegations to determine if the "gravamen" or "essence" of the complaint triggers SLUSA's preemptive effect. Courts likewise must be wary of attempts to evade SLUSA through "artful pleading." *Proctor v. Vishay Intertechnology, Inc.*, No. 07-16527, --- F.3d ----, 2009 WL 3260535, at *11-*12 (9th Cir. Oct. 9, 2009) (plaintiffs may not avoid SLUSA simply by pleading non-fraud claims); *Segal v. Fifth Third Bank, N.A.*, 581 F.3d. 305, 310-11 (6th Cir. 2009)

(courts must look to the substance of a complaint's allegations in applying SLUSA; plaintiffs may not avoid SLUSA simply by pleading non-fraud claims, omitting buzz words, and disavowing reliance on misrepresentations and omissions); *U.S. Mortgage*, 494 F.3d at 841 (9th Cir. 2007) (SLUSA bars state-law class action claims, including claims for breach of fiduciary duty and aiding and abetting breach of fiduciary, where the gravamen of the claims involves misstatements, omissions, and alleged deceptive and manipulative conduct in connection with federal securities transactions; efforts to sanitize formal allegations are unavailing).

ARGUMENT

I. Plaintiffs' State-Law Class Action Claims Are Barred By SLUSA.

SLUSA is the result of more than a decade of work by Congress to curb the abusive use of the class action device in cases involving federal securities transactions. Congress first sought to limit the abuse of the class action device in such cases by enacting the Private Securities Litigation Reform Act of 1995 (the "1995 Reform Act"), 15 U.S.C. §§ 77z-1 and 78u-4. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81 (2006) (recounting the history of 1995 Reform Act and SLUSA); *U.S. Mortgage*, 494 F.3d at 841-42 (same). The 1995 Reform Act, however, produced "unintended consequence[s]" for securities class actions nationwide. *Id.* The act applies only to class actions asserting private rights of action for

federal securities fraud, and "[r]ather than face the obstacles set in their path by the Reform Act, plaintiffs and their representatives began bringing class actions under state law, often in state court." *Id.*

To prevent this end-run, Congress enacted SLUSA. *Id.* SLUSA compels the dismissal of state law-based class actions involving misrepresentations, omissions, or deceptive or manipulative conduct in connection with the purchase or sale of covered securities. *Proctor*, --- F.3d. ----, 2009 WL 3260535, at *7-*8 & n.13, *11-*12; *U.S. Mortgage*, 494 F.3d at 841.

In keeping with this avowed Congressional purpose, SLUSA's application does not turn on the label attached to, or the specific elements of, the causes of action alleged in a particular complaint. That is, with very limited, express exceptions not relevant here, SLUSA applies any time the lawsuit: (1) involves a "covered class action"; (2) asserts a claim based on state law; (3) involves a "covered security"; and (4) alleges that the defendant misrepresented or omitted a material fact or employed any manipulative or deceptive device "in connection with the purchase or sale of a covered security." *Proctor*, --- F.3d ----, 2009 WL 3260535, *7-8 & n. 13, *11-*12 (stating requirements for SLUSA's application); *U.S. Mortgage*, 494 F.3d at 841 (same); *Patenaude*, 290 F.3d at 1025 (same).

A. Plaintiffs' State-Law Class Action Claims Involve The Purchase And Sale Of A Covered Security.

As Plaintiffs' briefing reveals, Plaintiffs' class action indisputably satisfies SLUSA's first three requirements.

First, the SAC encompasses a "covered class action"—*i.e.*, an action that seeks damages "on behalf of more than 50 persons or prospective class members." *See* AOB 3-19; ER 24-30 (SAC ¶¶ 23-49, Prayer) (seeking damages on behalf of a putative class of "thousands"). *See also* 15 U.S.C. § 78bb(f)(5)(B) (definition of a "covered class action").

Second, the class action's allegations are "based on" state law. *See* AOB 3-19; ER. 27-30. *See also* 15 U.S.C. § 78bb(f)(1).

Third, the class action allegations involve a "covered security." *See* AOB 4 n.1; ER 22-24 (SAC ¶¶8-22); *see also* 15 U.S.C. §§ 78bb(f)(5)(E) and 77r(b) (defining a "covered security" to include "any security issued by an investment company that is registered, or that has filed a registration statement, under the Investment Company Act of 1940").

As described above (pp. 3-5), Plaintiffs' variable universal life insurance policies are securities that meet this statutory definition. *See* SEC Rel. No. 33-5360, 1973 WL 149307 (Jan. 31, 1973) (recognizing that a variable life insurance policy is a "security" under the Securities Act of 1933 which is used to invest in the securities of one or more registered investment companies); *See* Practicing Law Institute, *Variable Annuities &*

Variable Life Insurance Regulation § 2:3.5 (same). The separate account and investment options associated with Plaintiffs' policies also are registered as "investment companies" under Section 8(b) of the Investment Company Act of 1940, 15 U.S.C. § 80a-8(b). And the monthly cost of insurance deductions at issue in this case are paid by the redemption of units in the same registered investment companies. *See* Dkt. 23, Exh. B at 98 (Pacific Life "deduct[s] the monthly charge from the investment options that make up your policy's accumulated value, in proportion to the accumulated value you have in each option.").[4]

Nothing more is needed to satisfy SLUSA's first three requirements.[5] *Herndon v. Equitable Variable Life Ins. Co.*, 325 F.3d 1252, 1254 (11th Cir. 2003)

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[4] *See* ER 66, 112, 154, 195, (signed acknowledgements by each Plaintiff that receipt of a prospectus for each separate account and underlying mutual fund associated with each policy); *see also* Dkt. 23, Exhs. A (registration statement), B (post-effective amendment including prospectus and statement of additional information), C (same), D (same).

[5] In their Opening Brief, Plaintiffs note that their putative class definition includes owners of variable universal life insurance policies (which all parties agree are "covered securities") and owners of non-variable universal life insurance policies (which Plaintiffs assert are not securities). AOB 4 n.1. However, the class definition and Plaintiffs' assertions about the characteristics of non-variable universal life insurance policies are of no moment because none of the Plaintiffs owned a non-variable universal life insurance policy. ER 18 (district court order granting motion to dismiss); 22-23 (SAC ¶¶ 11-12). And Plaintiffs have not challenged this aspect of the court's judgment on appeal.

(per curiam) (SLUSA applies to state-law class actions concerning variable life insurance policies with investments in mutual funds); *Dudek v. Prudential Securities, Inc.*, 295 F.3d 875, 878 (8th Cir. 2002) (same for variable annuities); *Patenaude*, 290 F.3d at 1025 (same).

B. Plaintiffs' State-law Class Action Claims Also Involve Alleged Misstatements And Omissions Of Material Facts And An Alleged Deceptive And Manipulative Scheme "In Connection With" The Purchase Or Sale Of Covered Securities.

Although Plaintiffs maintain otherwise, SLUSA's fourth requirement—alleged misrepresentations, omissions, deceptions or manipulation "in connection with" the purchase or sale of a covered security—is satisfied as well.

In their original complaint, Plaintiffs alleged that Pacific Life sold variable universal life insurance polices to Plaintiffs "with specific written promises and representations regarding the pricing components of the policies," including promises and representations that its monthly cost of insurance charge would be a "mortality" charge based on the company's actual cost of providing life insurance protection. ER 209-10 (CAC ¶¶ 8, 13). That complaint further alleged that these representations were "inaccurate"; that Pacific Life's cost of insurance charges were not based on the company's actual cost of providing life insurance protection; and that Pacific Life "intentionally" and "systematic[ally]" misrepresented the nature of the charge and "concealed expenses, overhead, and profit loads"

unrelated to the cost of insurance "within cost of insurance charges." ER 209, 211, 214 (CAC ¶¶ 9, 19, 33). *See* pp. 5-7 above (quoting additional allegations in the CAC). Finally, it also expressly alleged that, through this "deceitful" "scheme," Pacific Life was able to "generate undeserved revenues" for itself while levying "thousands" of dollars of excessive and improper cost of insurance charges against Plaintiffs and reducing the accumulated value of Plaintiffs' investments in their variable life insurance polices and separate accounts.

Once alerted to SLUSA's preclusive effect on their class action, Plaintiffs' counsel attempted an end-run and tried to (1) minimize the use of "buzz" words like "misrepresentation," "concealment," "deceitful," and "deceptive;" (2) avoid express references to the extensive disclosures that Pacific Life made to Plaintiffs in connection with the investments in their variable life insurance policies; and (3) limit their claims to cost of insurance charges assessed "at or after the commencement of the policy term." ER 20-30 (SAC). Their amended pleadings, however, retain the essence of the controversy and they continue to accuse Pacific Life of the *exact* same scheme, involving the *exact* same products, and the *exact* same charges through state-law class action claims.

Moreover, even after Plaintiffs' attempt to scrub their pleadings, the SAC still includes numerous express allegations of misrepresentations, omissions, and deceptive and manipulative conduct by Pacific Life in

furtherance of an alleged scheme to use the company's cost of insurance charge as a means of "divert[ing]" "hidden loads" from the accumulated cash value of Plaintiffs' investments. For example, Plaintiffs' SAC continues to allege that:

- Pacific Life sold Plaintiffs variable universal life insurance policies which "state that the Cost of Insurance charges are mortality charges . . . subject to calculation as defined in the policies" (ER 22 (SAC ¶¶ 8-9));
- the policies "identify" the cost of insurance charge as one of the "Monthly Deductions" that will be assessed against the accumulated value of Plaintiffs' investments (ER 23 (SAC ¶ 13));
- the cost of insurance charge is the policy's "mortality" charge and represents the amount that the insurer sets aside to pay death benefit claims (ER 23-24 (SAC ¶ 15));
- Pacific Life deducted "amounts unrelated to mortality" from the accumulated value of their policies each month "under the guise" of cost of insurance charges (ER 22 (SAC ¶ 10));
- Pacific Life "deducted" cost of insurance charges "in excess of the true mortality charges" (ER 24 (SAC ¶¶ 17, 36));
- Pacific Life deducted "hidden loads" in excess of true mortality charges and "wrongfully diverted" funds invested by Plaintiffs through their policies (ER 24 (SAC ¶ 21));
- the "hidden loads" have reduced the accumulated value of Plaintiffs' investments thereby causing damage to Plaintiffs that is "continuing in nature" (ER 24, 28 (SAC ¶¶ 22, 37));
- Pacific Life "concealed" in its quarterly statements the fact that it deducted excess charges (ER 28 (SAC ¶ 43));
- Pacific Life "knowingly and actively concealed and denied" the facts Plaintiffs allege (ER 27 (SAC ¶ 32));

- Pacific Life "kept" Plaintiffs, other policyholders, and the general public "ignorant of information essential to the pursuit" of claims related to cost of insurance charges (ER 27 (SAC ¶ 32)); and
- Pacific Life's alleged practice of charging hidden loads in its cost of insurance charge "constitutes an unfair, fraudulent, and/or unlawful business practice" (ER 28 (SAC ¶ 45)).

These allegations underscore that the changes to the pleadings are cosmetic. Rather, a fair reading shows that Pacific Life still is accused of making misstatements and omissions of material fact and engaging in deceptive and manipulative conduct related to the value of Plaintiffs' variable insurance policies. Indeed, Plaintiffs' Opening Brief tacitly concedes this point. *See* AOB 14 ("Plaintiffs alleged that Pacific Life failed to disclose its hidden loads").

C. Controlling Decisions By The U.S. Supreme Court And Federal Courts Make Clear That Plaintiffs' Allegations Satisfy SLUSA's Requirements.

Controlling authority from the U.S. Supreme Court makes it clear that Plaintiffs' complaints sufficiently allege misrepresentations, omission, and deceptive and manipulative conduct by Pacific Life "in connection with" the purchase and sale of covered securities. *See Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 81, 85-96 (2006); *SEC v. Zandford*, 535 U.S. 813, 819-20 (2002). These decisions squarely reject the narrow reading Plaintiffs advance.

In *Dabit*, the Supreme Court addressed the scope of SLUSA's "in connection with" requirement and held that the requirement should receive the same "broad construction" given to the "in connection with" language of Section 10(b) of the Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5. *See also U.S. Mortgage*, 494 F.3d at 844 (highlighting *Dabit's* broad construction); *Segal*, 581 F.3d at 308-11 (same). Furthermore, the Court explained that this broad construction extended "flexibly" to prohibit any deceptive practices "'*touching*'" the purchase or sale of a security. *Dabit*, 547 U.S. at 80, 85-88 (quoting *Superintendent of Insurance of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6, 12-13 (1971)) (emphasis in the Court's opinion).

> Under our precedents, it is enough that the fraud alleged "*coincide*" with a securities transaction—*whether by the plaintiff or by someone else*. … The requisite showing, in other words, is "deception 'in connection with the purchase or sale of any security,' not deception of an identifiable purchaser or seller."

547 U.S. at 85 (citations omitted) (emphasis added) (noting that this "broad" reading also comports with the long standing views of the SEC).

In adhering to this historic, broad construction of "in connection with," the Supreme Court considered and expressly rejected a narrow reading of the statutory language almost identical to the one advanced by Plaintiffs' counsel here—*i.e.*, a reading that assumes that SLUSA's "in connection with" language embraces only those particular cases where a private party would have standing to assert an implied private right of

action for securities fraud under Section 10(b) and Rule 10b-5 of the Exchange Act. *See Dabit*, 547 U.S. at 85-88 (noting that the prudential limitations placed on investors' implied private right of action under Section 10(b) and Rule 10b-5 do not stem from a construction of the statutory phrase "in connection with") (discussing *Blue Chip Stamps v. Mannor Drug Stores*, 421 U.S. 723 (1975)).

Zandford, 535 U.S. 813, one of the cases cited with approval in *Dabit*, confirms that proper application of SLUSA's "in connection with" requirement does not turn on whether an investor made an investment decision to purchase, sell, or hold a covered security in reliance on any misrepresentation, omission or deceptive or manipulative conduct. In *Zandford*, the SEC brought a civil action based on Section 10(b) and Rule 10b-5 against a broker whose clients had given him discretion to manage their account and a general power of attorney to make stock transactions on their behalf. Over time, the broker sold all the clients' stockholdings but diverted the sales proceeds to his own accounts. The Supreme Court held that the broker's ongoing scheme occurred "in connection with" the sale of the securities, even though his victim did not to make any investment decision to purchase or sell a security "in reliance" on the broker's post-transaction misrepresentation and omissions. *Id.* at 820. The broker's misrepresentations and omissions to his clients "coincided with the sales themselves," and each transaction was "deceptive because it was neither

authorized by, *nor disclosed to*" the broker's clients. *Id.* at 820-21 (emphasis added).

Plaintiffs' allegations here easily meet SLUSA's broad and flexible standard. Here, Plaintiffs have alleged that: (1) Pacific Life made misrepresentations and omissions in written policies and other documents concerning the charges that would be assessed against the accumulated cash values of their investments; (2) Pacific Life improperly included "hidden loads"—unrelated to the cost of providing life insurance benefits—within the "cost of insurance" charges deducted from the value of Plaintiffs' investment options; (3) these improper charges were "concealed from Plaintiffs in quarterly statements" and other documents; and (4) this alleged ongoing scheme affected the value of their policies' investment accounts each time the charges were made. As *Dabit* and *Zandford* establish, these allegations are sufficient to trigger SLUSA's class action bar.

In fact, federal courts repeatedly have ruled that SLUSA forecloses state-law class action claims substantially similar to Plaintiffs'—that is, those alleging a scheme by an insurer to charge inflated premiums and other allegedly excessive or improper charges "in connection with" investments in variable life insurance and variable annuity policies and the registered investment companies associated with such policies.

The Eleventh Circuit's decision in *Herndon* is illustrative. In *Herndon*, a policyholder brought a state-law class action against an insurance company for breach of contract, fraud, and other claims related to the pricing of variable life insurance policies. *See Herndon v. Equitable Variable Life Ins. Co.*, 253 F. Supp. 2d 1364, 1369 (S.D. Ga. 2002) (reciting each class action claim and finding them barred), *aff'd*, 325 F.3d at 1254-55. Specifically, the plaintiff alleged that the insurance company deliberately mis-designated the insured on a variable life insurance policy (a fifteen year-old non-smoker) as a "tobacco user" and intentionally misrepresented the terms of the policy in order to enrich itself through the charging of premiums that were higher than necessary (or allowed) under the policy. The district court dismissed the plaintiff's action based on SLUSA, and the plaintiff appealed, arguing that the insurance company's alleged misrepresentations, omissions, deception, and manipulation concerning the terms and fees of its policy were not made "in connection with" the purchase or sale of the variable life insurance policy. The Eighth Circuit rejected this argument. *Id.* at 1254-55. In particular, the Court noted that the plaintiff's argument concerning SLUSA's "in connection with" language had been considered and rejected in *Behlen v. Merrill Lynch*, 311 F.3d 1087, 1094 (11th Cir. 2002), and it held that SLUSA's "in connection with" language was satisfied by allegations that the defendant made misrepresentations and omissions concerning the terms of plaintiff's policy

in furtherance of a scheme to charge fees that were higher than necessary and that reduced the value of the plaintiff's investment.

In *Dudek*, 295 F.3d at 879-80, the Eighth Circuit faced a similar issue in a state-law class action asserting claims for breach of fiduciary duties, unjust enrichment, and conspiracy related to the marketing and pricing of tax-deferred variable annuities to customers whose investment accounts already enjoyed tax-deferred status. Plaintiffs alleged that the insurance company that issued their variable annuities made misrepresentations and omissions of material facts concerning the pricing and benefits associated with tax-deferred annuities. Although plaintiff argued that these allegations did not satisfy SLUSA's "in connection with" language, the Eighth Circuit found that "[i]n substance" plaintiffs' complaints "allege that defendants misstated or omitted material facts in connection with the purchase and sale of the tax-deferred annuities." *Id.*

Winne v. Equitable Life Assurance Society of U.S., 315 F.Supp.2d 404 (S.D.N.Y. 2003), followed a similar course. There, an investor in a variable annuity brought a putative class action against his insurer asserting state law causes of action for breach of contract, unjust enrichment, and violations of New York's statute prohibiting unlawful and unfair business practices. The plaintiff alleged that his insurer made misrepresentations and failed to disclose material information concerning the charges that would result from trading one variable annuity policy for another and then

charged him "penalty" fees when he elected to make a trade. The district court dismissed the action based on SLUSA, finding in relevant part that the allegations of misrepresentations and omissions satisfied SLUSA's "in connection with" requirement because the alleged misrepresentations, omissions and deceptive conduct concerned charges that were a "component" of the internal structure of the variable annuity that made the variable annuity less valuable.

Finally, in *Araujo v. John Hancock Life Ins. Co.*, 206 F.Supp.2d 377 (E.D.N.Y. 2002), SLUSA barred state-law class action claims against an insurance company for breach of contract and unjust enrichment related to an alleged scheme by the insurer to charge premiums on variable universal life insurance policies for a period of time during which no coverage was provided. *Id.* The court found that the policy, which allowed holders to invest in a choice of mutual funds, was a "covered security" and that the alleged fraud occurred "in connection with" the purchase and sale of a security. *Id.* at 383 (holding that "the alleged scheme ... goes to the value of the variable life insurance policy" alleging "in essence, the complaint alleges that the policyholders did not get what they thought they were getting.").

Plaintiffs' Opening Brief ignores *Herndon*, *Dudek*, and *Winne*. It does briefly cite *Araujo,* but contends that *Araujo* is distinguishable because it involved an allegation of a "deceptive practice" of selling and charging for

insurance for an initial period of time at the beginning of the policy during which the insurer in fact provided no coverage, "making the putative policy date a *factually untrue statement at the time it was made*." AOB 14-15 (emphasis in original). Yet, contrary to Plaintiffs' reading, *Araujo* did not turn on whether the policy date was a "factually untrue statement at the time it was made." Rather, SLUSA applied because "the alleged scheme to charge policyholders premiums during 'risk-free' periods goes to the value of the variable life insurance policy" and reduced the value of the securities the plaintiffs purchased. *Araujo*, 206 F.Supp.2d at 384.

Similarly, here, Plaintiffs have alleged that Pacific Life made misrepresentations, omissions, and engaged in deceptive and manipulative conduct before and after Plaintiffs invested in variable life insurance policies—all as part of a scheme to charge "hidden loads" that reduced the value of the securities that the Plaintiffs purchased. *Herndon*, *Dudek*, *Winne*, and *Araujo* thus reinforce the conclusion that Plaintiffs' claims concern misrepresentations, omissions, and deceptive and manipulative conduct "in connection with" the purchase and sale of "covered securities" and therefore are subject to SLUSA's class action bar.

II. Plaintiffs Offer No Factual Or Legal Basis On Which To Avoid The Controlling Law Barring Their State-Law Class Action Claims.

In their Opening Brief, Plaintiffs argue that: (1) SLUSA bars only those claims that sound in fraud or "depend" on allegations of a

misrepresentation or omission; (2) SLUSA prohibits only those claims where a plaintiff is alleged to have made an investment decision "in reliance" on a misrepresentation or omission and where a plaintiff's factual allegations therefore could give rise to an implied private right of action under federal securities laws; and (3) their amended complaints successfully avoid SLUSA's ambit by minimizing references to the buzz words of fraud. Each of these arguments is unsustainable in light of controlling law.

A. SLUSA Is Not Limited To State-Law Causes Of Action That "Depend" On Alleged Misrepresentations Or Omissions.

To begin with, Plaintiffs are wrong when they contend that SLUSA forecloses only those state-law class action claims that "depend" on allegations of misrepresentations or omissions. AOB 13-17.

SLUSA's plain language expressly applies to any class action "based upon" state law alleging a misrepresentation or omission of a material fact or deceptive or manipulative conduct "in connection with" the purchase or sale of a covered security. 15 U.S.C. §§ 77p(b), 78bb(f)(1). Although Congress certainly could have limited SLUSA's scope to only those state-law class action claims that are brought for fraud or that "depend" on allegations of misrepresentations or omissions under state law, Congress did not do so. To the contrary, Congress enacted a statute with a much wider preclusive effect, subject only to a discrete number of express and

narrowly "tailored" statutory exceptions. *See Dabit*, 547 U.S. at 87-88. None of those exceptions are applicable here, and, under *Dabit*, the Court may not construe SLUSA in a manner that would "create" any "additional, implied exceptions. *Id.* Thus, as this Court recently explained in *Proctor*, a "[m]isrepresentation need not be a specific element of the claim to fall within the Act's preclusion." --- F.3d ----, 2009 WL 3260535, at *7 n.13 (citing cases) (holding class claims for breach of fiduciary duties barred by SLUSA); *see also U.S. Mortgage*, 494 F.3d at 844-45 (same).

In addition to *Proctor* and *U.S. Mortgage*, numerous other courts have considered and rejected arguments that are indistinguishable from the one Plaintiffs press here. For example, in *Segal*, the Sixth Circuit examined *Dabit*, *Zandford*, *U.S. Mortgage*, and several other cases construing SLUSA and concluded that SLUSA's "in connection with" requirement was satisfied by allegations that a trustee-bank had breached a contract, violated state fiduciary duties, and reaped unjust enrichment when it allegedly made misstatements and omissions to its clients before and after charging fees associated with the investment of trust assets in shares of mutual funds managed by an affiliate of the trustee-bank. *Segal*, 581 F.3d. at 311. The Court specifically rejected the argument that SLUSA forecloses only those state-law class action claims that "*depend* upon allegations of misrepresentation or manipulation" calling this argument "unavailing." *Id.* (emphasis added). "The Act does not ask whether the complaint makes

'material' or 'dependent' allegations of misrepresentation in connection with buying or selling securities. It asks whether the complaint includes these types of allegations, pure and simple." *Id.*

In *Miller v. Nationwide Life Ins. Co.*, 391 F.3d 698, 701-02 (5th Cir. 2004), the Fifth Circuit's analysis followed the same course. Like Plaintiffs here, Miller argued that SLUSA did not apply to a breach of contract claim asserted against an insurance company that sold variable annuities because allegations of misrepresentations and omissions and deceptive and manipulative conduct were not necessary to his cause of action under state law. However, the court rejected Miller's construction and his self-serving characterization of the gravamen of his contract claim: "The interpretation of SLUSA that Miller proposes would circumvent both the plain meaning of the statutory text and Congress' clearly expressed purpose in enacting it." *Id.* SLUSA applied to the Miller's contract claim concerning fees charged against the value of his variable annuity policies because his pleading described conduct related to transactions within SLUSA's purview. *See also Rowinski v. Salomon Smith Barney, Inc.*, 398 F.3d 294, 304 (3d Cir. 2005) (same).

In *Kutten v. Bank of America, N.A.*, 530 F.3d 669 (8th Cir. 2008), *cert. denied*, 129 S.Ct. 598 (2008), the Eighth Circuit also rejected Plaintiffs' argument and confirmed that it is the substance of the conduct alleged, not the elements of legal claims, that controls:

> In determining whether SLUSA applies, we do not rely on the names of the causes of action that the plaintiff alleges. Instead we look at the substance of the allegations, based on a fair reading. *** SLUSA preemption is *based on the conduct alleged*, not *the words used to describe the conduct*.

Id. at 670-71 (emphasis added).

Indeed, an overwhelming number of courts have found that SLUSA preempts class action claims for breach of contract, breach of fiduciary duties, duties of good faith and fair dealing, unjust enrichment, and violations of state consumer protection and trade practices statutes whenever the "gravamen" or "essence" of the claims concerns an alleged scheme that involves misstatements, omissions, and deceptive and manipulative conduct in transactions that can be connected to federal securities.

According to these cases, it is immaterial whether alleged misstatements, omissions, and deception are legally required to support claims for breach of contract or other claims or whether Plaintiffs' claims "depend" on allegations of misstatements, omissions, deception, or manipulation. What matters instead is that Plaintiffs have asserted a state-law class action that is predicated in some fashion on allegations that Pacific Life made misstatements and omissions and engaged in deceptive and manipulative conduct "in connection with" the "cost of insurance" charges assessed against Plaintiffs' investments. *E.g.*, *Anderson v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 521 F.3d 1278, 1286 (10th Cir. 2008) (class

claims for breach of fiduciary duty, negligence, violations of state securities laws, and aiding and abetting tortious action); *Dudek*, 295 F.3d at 879-80 (class claims for breach of fiduciary duty and unjust enrichment); *In re Edward Jones Holders Litigation*, 453 F.Supp.2d 1210, 1214-17 & n.7 (C.D. Cal. 2006) (class claims under Section 17200 and for breach of fiduciary duties of loyalty, care, and prudent investing); *Beckett v. Mellon Investor Services, LLC*, No. C06-5245FDB, 2006 WL 3249189, at **3-4 (W.D. Wash. Nov. 8, 2006) (class claims for breach of contract, agency, and fiduciary duties, as well as unjust enrichment, and state statutory violations).

For the same reason, Plaintiffs fare no better when they contend that the "gravamen" of their claims attacks only what Pacific Life allegedly did with respect to the cost of insurance charge "following" the issuance of their policies and not what Pacific Life allegedly said before. AOB 14.

First, the statutory text does not draw a distinction between statements and conduct. On the contrary, SLUSA applies to allegations of *either* misstatements or omissions of material facts *or* the use a deceptive or manipulative device or contrivance "in connection with" the purchase or sale of a covered security. Likewise, SLUSA does not require that allegations that misstatements or omissions or deception or manipulation occur before the purchase or sale of covered security. To the contrary, and as noted above, it is well settled that SLUSA's "in connection with" requirement may be satisfied by any allegation that touches on or coincides

with a securities transaction regardless of whether it occurred before or after the securities transaction. *See* pp. 21-23 above (discussing *Dabit* and *Zandford*), pp. 24-27 above (discussing cases involving similar claims related to variable insurance products), and pp. 29-38 below (discussing controlling case law construing SLUSA's "in connection with" language broadly and flexibly to similar claims alleging misrepresentations, omissions, or deception touching on securities transactions).

Second, Plaintiffs' allegations show that they are attacking alleged misstatements, omissions, and acts of deception and manipulation occurring *before*, *during*, and *after* the issuance of their policies and Pacific Life's monthly deductions from the accumulated value of their investment options. ER 22-24, 27-28 (SAC ¶¶ 8-10, 13, 15, 17, 21, 22, 32, 37, 45) (accusing Pacific Life of misrepresentations, omissions, deception, and manipulation in Plaintiffs' written policies themselves and in "quarterly statements" sent after Pacific Life deducted cost of insurance charges, among other things)). Indeed, the documents included with or referenced by the Complaint establish that the cost of insurance charges are paid for each month through the sale and redemption of units in the Separate Account that funds Plaintiffs' policies, making each cost of insurance charge at issue one that involves the purchase or sale of a covered security within the ambit of SLUSA. *See* pp. 4, 6 & n.1, 15-16 above.

Third, Plaintiffs' express allegations of misstatements, omissions, and deceptive and manipulative conduct cannot be fairly or accurately characterized as "extraneous" to the scheme that they have alleged. AOB 14. As the Eighth Circuit explained in *Kutten*, alleged misrepresentations, omissions, deception, and manipulation are part of the "gravamen" of their claims because this conduct relates directly to the transactions that Plaintiffs attack—and it is the nature of the alleged transaction that controls, not the elements of any particular cause of action. The gravamen of the SAC is that Pacific Life did not deal honestly with Plaintiffs when policies were issued, concealed "hidden loads" in cost of insurance charges, deducted those charges from the value of investments in covered securities, and covered up their conduct in quarterly statements and other documents. ER 21-29 (SAC ¶¶1-49). That is what brings their claims within SLUSA's ambit.

Tellingly, Plaintiffs argue their contrary view by relying almost entirely on cases decided before *Dabit*. AOB 10-13 (citing *Falkowski v. Imation Corp.*, 309 F.3d 1123, 1131 (9th 2002); *Green v. Ameritrade, Inc.*, 279 F.3d 590, 598 (8th Cir. 2002); *Webster v. New York Life Ins. and Annuity Corp.*, 386 F.Supp.2d 438, 441 (S.D.N.Y. 2005); *Norman v. Salomon Smith Barney Inc.*, 350 F.Supp.2d 382 (S.D.N.Y. 2004); *Xpedior Creditor Trust v. Credit Suisse First Boston (USA) Inc.*, 341 F.Supp.2d 258, 269 (S.D.N.Y. 2004); *Magyery v. Transamerica Financial Advisors, Inc.*, 315 F.Supp.2d 954, 957

(N.D. Ind. 2004)). However, *Dabit*'s reasoning and holding on the construction of SLUSA's relevant statutory language—misrepresentations, omissions, deception, and manipulation "in connection with" the purchase and sale of a covered security—dispensed with the notion that allegations of misrepresentation and omission or deception and manipulation had to be an element of the state law cause of action.

None of Plaintiff's pre-*Dabit* citations therefore is apposite, much less controlling, on this issue post-*Dabit*. That is why, following *Dabit*, courts have recognized that the reasoning in these cases no longer are good law. *Compare Falkowski v. Imation Corp.*, 309 F.3d at 1131 (following *Green v. Ameritrade, Inc.*) *with Siepel v. Bank of America, N.A.*, 526 F.3d 1122, 1127 (8th Cir. 2008) (recognizing that *Green*'s construction of "in connection with" was overruled in *Dabit*). And that is why in its post-*Dabit* decisions in *Proctor* and *U.S. Mortgage*, this Court has held that SLUSA precludes state-law class action claims, irrespective of whether the asserted state-law claims "depend" on allegations of misrepresentations and omissions of material facts or acts of deception or manipulation. *See Proctor*, --- F.3d. ----, 2009 WL 3260535, at *11-12; *U.S. Mortgage*, 494 F.3d at 840, 843-45.[6]

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[6] Plaintiffs' other cited authorities are inapposite because they do not even involve the construction of SLUSA nor do the address the construction on the "in connection with" requirement post *Dabit* and *Zandford*. AOB 13 (citing *Mills v. Polar Molecular Corp.*, 12 F.3d 1170, 1174 (2d Cir. 1993); *In re: Weeks*, SEC Rel. No. 199 (2002) (administrative law

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B. SLUSA's Scope Cannot Be Narrowed By Reference To Prudential Limitations On Implied Private Rights Of Action For Securities Fraud Under SEC Rule 10b-5.

Plaintiffs also miss the mark when they argue that SLUSA prohibits only those claims where a plaintiff is alleged to have made an investment decision "in reliance" on a misrepresentation or omission and where a plaintiff's factual allegations could give rise to an implied private right of action under federal securities laws. AOB 10 (contending that "[t]he question here is whether Plaintiffs' Complaint alleges claims that ought to be brought as securities fraud claims."); 17-19 (contending that allegations of an investment decision in "reliance" on misstatements or omissions is necessary under SLUSA).

The Sixth Circuit recently rejected this very argument in *Segal*, as both contrary to the text of SLUSA and the Supreme Court's decision in *Dabit*.

> That is not what the Act says. And *Dabit*, at any rate, held that SLUSA precludes even state law claims that would not meet the 'policy'-based standing limitations the Court has attached to Rule 10b-5.

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judge initial decision finding securities violations related to nondisclosures); *Klorer v. Bennett*, No. 89-3430, 1990 WL 94241 (6th Cir. Jul 9, 1990) (unpublished); *Consolidation Services, Inc. v. KeyBank Nat. Ass'n*, 185 F.3d 817 (7th Cir. 1999)).

Segal, 581 F.3d at 312 (noting that numerous circuits have now rejected Plaintiffs' narrow reading of SLUSA).

In *Siepel,* 526 F.3d at 1127, the Eighth Circuit also considered and rejected the arguments pressed by Plaintiffs' here. As the Court explained, "[w]hen [*Dabit*] rejected the *Blue Chip Stamps* limitation [on implied private rights of action under Section 10(b) and Rule 10b-5], [it] rejected wholesale the proposition that limitations on private Rule 10b-5 actions may be applied to limit the scope of SLUSA." *Id.* "Separated from the policy considerations that can limit the private right of action, the "in connection with" standard of Section 10(b) is construed flexibly, not technically or restrictively."

> The Plaintiffs argue that the Bank's non-disclosure was not "in connection with" the purchase of the securities, such that the non-disclosure did not relate to a decision whether to purchase a security. … Under *Dabit*, however, "it is enough that the fraud alleged 'coincide' with a securities transaction-whether by the plaintiff or by someone else." *Dabit*, 547 U.S. at 85, 126 S.Ct. 1503. The Plaintiffs' complaint alleges nondisclosures that clearly coincided with the Bank's purchase of shares in the Nations Funds mutual fund. Given the identical coverage of Section 10(b) and SLUSA, it follows that the Plaintiffs' state-law claims are preempted.

Id. See also Kutten, 530 F.3d at 670-71 (same); *Rabin v. JPMorgan Chase Bank, N.A.*, No. 06-C-5452, 2007 WL 2295795 (N.D. Ill. Aug. 3, 2007) (same); *Wells*

Fargo Bank, N.A. v. Superior Court of San Francisco County, 159 Cal.App.4th 381 (Cal. App. 1st Dist. 2008) (same).

This Court's own decision in *U.S. Mortgage* is to the same effect. There, this Court held that it was immaterial that (a) the plaintiffs did not personally make an investment decision to purchase, sell, or hold any stock in reliance on deceptive statements or conduct and (b) the plaintiffs could not bring a private action based on federal securities laws. As the Court observed, *Dabit* requires only that alleged misrepresentations and omissions and deceptive conduct "coincide" with transactions involving covered securities, broadly speaking. *Id.*[7]

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[7] In *Cheatham v. Kentucky Lottery Corp.*, No. 3:07-CV-391-S, 2008 WL 90034 (W.D. Ky. Jan. 8, 2008), the only post-*Dabit* case cited by Plaintiffs, a district court in the Sixth Circuit found SLUSA inapplicable to a class action in which the named plaintiff's allegations concerned specific terms of employment that had nothing to do with the value of the plaintiff's retirement plan investments. *Cheatham*, accordingly, has no relevance because the SAC does allege misrepresentations, omissions, and deceptive and manipulative conduct in furtherance of the scheme that did allegedly affect the value of Plaintiff's investments in covered securities. In any event, *Cheatham* does not contain any reasoned analysis of *Dabit* or the other cases applying *Dabit*. To the contrary, it assumes that SLUSA applies only to state law claims that "replicate" the elements of a private action for federal securities fraud—an assumption expressly rejected in *Dabit*. And its reasoning has been superseded by the Sixth Circuit's controlling decision in *Segal*.

C. SLUSA May Not Be Avoided By "Artful Pleading."

Plaintiffs also are wrong when they contend that: (1) the district court erred by considering express allegations of misrepresentations, omissions, and deceitful conduct included in Plaintiffs' original complaint when ruling on Pacific Life's motion to dismiss Plaintiffs' SAC; and (2) Plaintiffs' SAC should not have been dismissed because Plaintiffs do not intend to rely on any allegation of misrepresentations or omissions or deceptive or manipulative conduct in bringing their breach of contract claim. AOB 15-17. These arguments fail for multiple reasons.

1. Plaintiffs Mischaracterize *U.S. Mortgage* And Disregard Controlling Authority Condemning Artful Attempts To Plead Around SLUSA.

First, Plaintiffs mischaracterize *U.S. Mortgage*, 494 F.3d at 842-44, when they assert that the district court erred by looking at the allegations in their original complaint. In *U.S. Mortgage*, this Court held that SLUSA does not prohibit the amendment of a complaint after it has been *removed* from state court where the amendment seeks to clarify a state law claim that may have been "*inadvertently pled*." *Id.* (emphasis added). That particular holding—which was confined to SLUSA's statutory limitations on the Court's removal jurisdiction—has no bearing on a case like this one which was brought in federal court in the first instance.

More importantly, and contrary to Plaintiffs' briefing, *U.S. Mortgage* does not give any plaintiff an unlimited right to plead, re-plead, and re-

plead yet again in an effort to evade SLUSA; nor does *U.S. Mortgage* require that a district court disregard either the form or substance of what has been alleged in prior pleadings when evaluating whether a new pleading states a claim to which SLUSA applies. To the contrary, *U.S. Mortgage* expressly warns *against* the dangers of amendments that attempt to "artfully plead" around SLUSA, describing such evasion as "precisely" what SLUSA was enacted to stop. *Id.* And it indicates that, in light of SLUSA's "statutory silence" on amendments and the "existence of competing policy rationales," district courts should exercise "discretion" when considering whether an amended pleading is a legitimate clarification of an "inadvertently pled" state law claim or an improper attempt to "artfully plead" around SLUSA. *Id.*

In *U.S. Mortgage* itself, the Court examined the complete procedural history of the litigation, including *all* of the plaintiffs' pleadings, in the course of evaluating whether the plaintiff's operative complaint was barred by SLUSA. And the Court concluded that the plaintiffs' attempts to amend their pleading to avoid SLUSA failed. *Id.* (concluding that the plaintiffs' second amended complaint was properly dismissed with prejudice, notwithstanding their attempts to sanitize the pleadings, because it continued to complain of a deceptive scheme that coincided with transactions in covered securities).

U.S. Mortgage is consistent with the decisions of numerous courts that hold that a plaintiff may not "plead around" SLUSA by avoiding direct references to misrepresentations and omissions or the deceptive or manipulative aspects of an alleged scheme or by asserting only non-fraud state law claims or by disavowing any intention to rely on allegations of deception or manipulation. *See Segal*, 581 F.3d at 310-11 (rejecting arguments identical to Plaintiffs' here); *Siepel*, 526 F.3d at 1127 (same), *aff'g*, 239 F.R.D. 558, 570-72 (E.D. Mo. 2006) (denying leave to amend where amended complaint simply aimed to "mask" allegations of misrepresentations and omissions and thus was improper and futile); *Kutten*, 530 F.3d. at 669-70 (same), *aff'g*, No. 06-937, 2007 WL 2485001, at **4-8 (E.D. Mo. Aug. 29, 2007) (rejecting the argument that SLUSA did not apply because allegations of fraud, misrepresentations, omissions, and deception were "ancillary" to breach of fiduciary duty claims); *Behlen*, 311 F.3d at 1092 (SLUSA applied notwithstanding plaintiff's attempt to sanitize the complaint of references to misstatements, omissions, and deceptive and manipulative conduct); *Dudek*, 295 F.3d at 879-80 (SLUSA applied notwithstanding plaintiff's attempt to delete allegations of fraud, misrepresentation, and omission); *Felton v. Morgan Stanley Dean Witter & Co.*, 429 F.Supp.2d 684, 692-93 (S.D.N.Y. 2006) ("To regard the Amended Complaint as alleging nothing more than common law breaches of contract would reward artful pleading in a manner that the law does not permit."); *Beckett*, 2006 WL 3249189, at **2-4 (same); *Kurz v. Fidelity Management &*

Research Co., No. 07-cv-709, 2008 WL 2397582, at *3 (S.D. Ill. June 10, 2008) (SLUSA applied even though the complaint "scrupulously" avoided the buzz words of "fraud, misrepresentation, or omission," and included "a paragraph specifically disclaiming any such allegations"); *Araujo*, 206 F.Supp.2d at 384 (plaintiff may not "avoid SLUSA by omitting the allegations of fraud in the amended complaint.").[8]

2. Plaintiffs' Attempt At Evading SLUSA Is Transparent And Unavailing.

In this case, as the district court observed, Plaintiffs' attempt at evasion is transparent. ER 18. Their SAC attacks the *exact* same scheme and asserts the *exact* same state-law class action claims as their original complaint, which contained numerous allegations of express misrepresentations and omissions and deceptive and manipulative conduct. Counsel simply deleted obvious "buzz" words—such as "misstatements," "omissions," and "deceitful" conduct—as well as references to the content of disclosures actually provided to Plaintiffs.

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[8] Even under Plaintiffs' flawed approach to reviewing amended pleadings, the district court was correct to dismiss Plaintiffs' SAC because that pleading continued to include numerous *express* allegations of misrepresentations, omissions, and deceptive and manipulative conduct by Pacific Life as part of an alleged scheme to deduct hidden loads from the value of Plaintiffs' investments. *See* ER 22-28 (SAC ¶¶ 8-10, 13, 15, 21-22, 26, 32, 34-37, 39-41, 43-45).

Further, the SAC continues to include numerous *express* allegations of misrepresentations, omissions, and deceptive and manipulative conduct by Pacific Life as part of an alleged scheme to deduct hidden loads from the value of Plaintiffs' investments. *Compare* ER 22-28 (SAC ¶¶ 8-10, 13, 15, 21-22, 26, 32, 34-37, 39-41, 43-45) *with Segal*, 581 F.3d. at 311 ("Although Segal disclaims any allegation of 'misrepresentation or failure to disclose material facts,' … the remainder of the amended complaint shows otherwise.").

Moreover, the editing of buzz words does not change the "crux" or "gravamen" of a plaintiff's allegations or claims or avoid SLUSA's bar. *See Segal*, 581 F.3d. at 310-11. As the Sixth Circuit observed, a plaintiff cannot "elude SLUSA's prohibitions by editing out covered words from the complaint" or "disclaiming their presence." *Id.* [9]

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[9] Plaintiffs' citation (AOB 16) to *Beary v. ING Life Ins. & Annuity Co.*, 520 F.Supp.2d 356 (D. Conn. 2007), does not cast doubt on the application of SLUSA to Plaintiffs' SAC. *Beary* involved factual allegations and claims different than those alleged here and in the other cases cited above which do expressly attack Pacific Life for alleged statements, omissions, failures to disclose, and other deceptive and manipulative conduct. *Beary* likewise never addressed the wealth of authority which prohibits artful pleading to try to avoid SLUSA preemptions. *See* pp. 39-42 above. Indeed, in *Beary*, the court had no occasion to carefully scrutinize the complaint to determine whether its gravamen concerned a deceptive scheme triggering SLUSA; plaintiff's own complaint and concessions at oral argument meant that the

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III. Dismissal Of Plaintiffs' Complaint Does Not Interfere With State Contract Law In Any Respect.

Plaintiffs also run misperceive controlling law when they contend that, under *Dabit*, their class action claim for breach of contract is a "'historically entrenched" state-law remedy beyond the scope of what Congress intended to preclude when it enacted SLUSA. AOB 11 (quoting *Dabit*, 547 U.S. at 88).

To begin with, Plaintiffs' argument again runs counter to the plain language of the statute, which (as previously noted) bars any state-law class action that satisfies SLUSA's four requirements and is subject only to a discrete number of express and narrowly "tailored" statutory exceptions that have no bearing on this case. *See Dabit*, 547 U.S. at 87-88.

Moreover, Plaintiffs' argument mischaracterizes what the Supreme Court held in *Dabit*. Indeed, *Dabit* considered and rejected an argument

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Continued from previous page
complaint failed to state a claim under state trust law and therefore had to be dismissed regardless of whether SLUSA applied. *Id.*

The application of SLUSA to Plaintiffs' SAC also is not disturbed by any of the other cases cited by Plaintiffs (AOB 17), purportedly involving claims related to cost of insurance charges on non-variable universal life insurance policies. None of these cases addressed SLUSA or its preclusive effect on state-law class actions involving misrepresentations, omissions, deception or manipulation in connection with the purchase or sale of a covered security.

substantially similar to Plaintiffs' argument here. In *Dabit*, the plaintiffs argued that a broad and flexible construction of SLUSA's "in connection with" language would eliminate historically entrenched state law remedies for breach of fiduciary duties and the duty of good faith and fair dealing. Congress, the plaintiffs argued, could not have intended SLUSA to interfere with these state-law causes of action. The Court, however, disagreed. First, the Court observed that "SLUSA does not actually pre-empt any state cause of action. It simply denies plaintiffs the right to use the class-action device to vindicate certain claims [on behalf of a group of 50 plaintiffs or more]." 547 U.S. at 87-88. Second, the Court recognized that federalism concerns about the displacement of state law are weak in cases like this one because federal law, not state law, has long been the "principal vehicle" for asserting any kind of class action claim related to a securities transaction. *Id.* (citing legislative history). Third, the Court noted that SLUSA's broad preclusive language and narrowly tailored statutory exceptions demonstrated that Congress carefully considered SLUSA's effect on state law remedies, making "additional, implied exceptions" "inappropriate." *Id.* Fourth, the Court reasoned that while state law claims for breach of fiduciary duties and the duty of good faith and fair dealing and similar theories theoretically were available before SLUSA in cases involving securities transactions, nothing suggested that such state-law class action claims were commonplace. "This is hardly a situation, then, in

which a federal statute has eliminated a historically entrenched state-law remedy." *Id.*

Given *Dabit*'s analysis, this Court also must reject Plaintiffs' contention SLUSA cannot be applied to their class action claim for breach of contract. SLUSA's application does not, as Plaintiffs suggest, "eliminate" any remedy for a would-be plaintiff who is willing to avoid pleading any class action prohibited by federal law. SLUSA applies only to state law claims that are brought as covered class actions seeking damages by a named plaintiff on behalf of a class or a group of more than fifty named people. *U.S. Mortgage*, 494 F.3d at 843-45 (noting that SLUSA does not preempt any substantive state law or deprive any individual of a remedy; rather, SLUSA simply restricts the use of the class action "procedural device"). SLUSA's application here, accordingly, furthers federal policies and objectives without unduly interfering with any traditional state law prerogatives.

IV. Plaintiffs Have Waived Any Right To Argue That They Should Have Been Given Leave To File Another Amended Complaint; Moreover, The District Court Did Not Err When It Dismissed Their Action With Prejudice.

Plaintiffs maintain that the district court committed reversible error when it dismissed their SAC with prejudice because they should have been given leave to amend to assert individual claims that would fall outside of SLUSA. This argument should be rejected on several grounds.

First, Plaintiffs have waived any right to raise this issue on appeal. In the district court, Plaintiffs filed three separate pleadings, each asserting a class action. They steadfastly opposed dismissal of their class action by arguing that SLUSA did not apply to their class action claims. At no point did Plaintiffs ever argue that dismissal with prejudice was inappropriate based on the possibility that they would reverse course and assert individual claims only. Nor did Plaintiffs ever propose filing an amended complaint asserting only individual claims.

Because Plaintiffs failed to raise any issue in the district court about proceeding with individual claims only, they have waived the right to raise the issue for the first time on appeal. "'[I]t is well-established that an appellate court will not consider issues that were not properly raised before the district court.... It follows that if a party fails to raise an objection to an issue before judgment, he or she waives the right to challenge the issue on appeal.'" *Silvas v. E*Trade Mortg. Corp.*, 514 F.3d 1001, 1007 (9th Cir. 2008); *Doi v. Halekulani Corp.*, 276 F.3d 1131 (9th Cir. 2002) (same); *Crawford v. Lungren*, 96 F.3d 380, 389 n. 6 (9th Cir. 1996) (same). *See also Herndon*, 325 F.3d at 1255 (court was not required to consider whether the district court should have dismissed only the class action components of the plaintiffs' variable life insurance claims because the plaintiffs never told the district court that they were willing to assert individual claims).

Second, dismissal with prejudice is warranted and routinely granted under circumstances such as these. The text of SLUSA makes clear that no covered class action that falls within its ambit may be "maintained" in any state or federal court by any private party. Accordingly, courts have recognized that dismissal is mandatory if a complaint satisfies SLUSA's requirements. *See U.S. Mortgage*, 494 F.3d at 844. While a court may have discretion to allow amendments under certain circumstances, courts have recognized that SLUSA requires dismissal with prejudice where (as here) a plaintiff has filed numerous class action complaints subject to SLUSA. *Id.* (affirming the dismissal of plaintiffs' second amended complaint with prejudice). "Pleading is not an interactive game in which plaintiffs file a complaint and then volley it over a rhetorical net with the court until a viable complaint emerges. Plaintiffs have the responsibility to plead their case adequately, without defendants' or the court's assistance. A court may deny a plaintiff leave to replead when the party 'has been given ample opportunity to allege a claim.'" *Siepel v. Bank of America, N.A.*, 239 F.R.D. 558, 571 (E.D.Mo. 2006), *aff'd*, 562 F.3d at 1127.

Third, Plaintiffs' argument should be rejected because, on this record, Plaintiffs have not and cannot show that a district court would have subject matter jurisdiction over an action concerning their individual cost of insurance charges. Any individual action that Plaintiffs could bring would have to be premised upon 28 U.S.C. § 1332(a) (diversity) and therefore

would have to meet the statute's $ 75,000 amount in controversy requirement as to each Plaintiff's claims. However, the Plaintiffs have not alleged any facts sufficient to show that their respective claims for excessive or improper cost of insurance charges satisfies the statute's $75,000 amount in controversy requirement. *See Citizens Committee to Save Land Grant Railroads v. Burlington Northern, Inc.*, 708 F.2d 1430 (9th Cir. 1983) (court could not exercise diversity jurisdiction over a bond-related claim where the operative pleading made no sufficient allegations regarding the dollar amount in controversy). Nor can they supplement the record or make extra-record assertions to support a threshold question of subject matter jurisdiction. Because the record on appeal does not support their argument, the Court cannot grant their request or fault the district court for dismissing their action. For this reason as well, the Court should hold that the district court did not err.

CONCLUSION

The controlling case law speaks with one voice in cases like this: The district court's judgment of dismissal comports fully with SLUSA text, the precedents of the Supreme Court, and numerous decisions of this Court and its sister courts. The judgment should be affirmed.

November 4, 2009

Respectfully submitted,

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STATEMENT OF RELATED CASES

Pursuant to Ninth Circuit Rule 28-2.6, Pacific Life is not aware of any related case pending in this Court.

November 4, 2009

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CERTIFICATE OF COMPLIANCE

Pursuant to Fed. R. App. P. 32 (a)(7)(C) and Ninth Circuit Rule 32-1, the attached opening brief is proportionately spaced, has a plain Roman typeface of 14 points or more and contains 11,326 words, excluding the parts of the brief exempted by Rule 32(a)(7)(b)(iii), as counted by Microsoft Word 2003, the word processing software used to prepare this brief.

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CERTIFICATE OF SERVICE

I hereby certify that on November 4, 2009, I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the CM/ECF system. I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

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Freeman Investments, L.P. v. Pacific Life Insurance Company
No. 09-55513 (9th Cir.)

Dear Counsel:

This morning we telephoned the offices of Mr. Sherman and Mr. Paul to inform you that we would be orally requesting a 14-day extension of time to file the Appellee's answer brief and supplemental record excerpts in the above-captioned case. *See* 9th Cir. R. 31-2.2(a) (authorizing such requests). We subsequently made our request via a telephone call to the Office of the Clerk of the Ninth Circuit, and our request was granted by the clerk's designated deputy. As a result of the extension, Appellee's answer brief shall be due on November 4, 2009 and any reply shall be due 14 days after service of the answer brief.

If you have any questions or concerns, please do not hesitate to write or call.

Cordially,

David J. Bird

DJB:sv