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UNITED STATES DISTRICT COURT
CENTRAL DISTRICT OF CALIFORNIA
SOUTHERN DIVISION
THE HONORABLE JAMES V. SELNA, JUDGE PRESIDING
CERTIFIED TRANSCRIPT
JOYCE WALKER, et al., } TRIAL DAY 11
Plaintiffs, }
vs. }
LIFE INSURANCE COMPANY OF) SACV-10-09198-JVS
SOUTHWEST, et al.,)
Defendants. }
-----}

REPORTER'S TRANSCRIPT OF PROCEEDINGS
Santa Ana, California
April 24, 2014

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|------------------------|--------|-------|----------|----------|
| I-N-D-E-X | | | | |
| PLAINTIFFS' WITNESSES: | DIRECT | CROSS | REDIRECT | RECROSS |
| (None) | | | | |
| PLAINTIFFS' EXHIBITS: | | | MARKED | RECEIVED |
| Exhibit 80 | | | | 122 |
| Exhibit 574 | | | | 124 |
| DEFENSE WITNESSES: | DIRECT | CROSS | REDIRECT | RECROSS |
| JEFFREY STEMLER | 15 | 86 | | |
| CRAIG SMITH | 135 | 164 | 203 | 215 |
| DEFENSE EXHIBITS: | | | MARKED | RECEIVED |
| Exhibit 867-C | | | | 30 |
| Exhibit 774 | | | | 39 |
| Exhibit 867-D | | | | 76 |
| Exhibit 251-A | | | | 208 |
| Exhibit 226-A | | | | 210 |

1 SANTA ANA, CALIFORNIA; THURSDAY, APRIL 24, 2014; 8:04 A.M.

07:44:26 2 (Jury not present)

08:04:07 3 THE COURT: Good morning. Given that one of our
08:04:10 4 jurors is delayed, there are a couple of things I think we
08:04:14 5 can take up.

08:04:15 6 First of all, would you state your appearances,
08:04:17 7 please.

08:04:18 8 MR. BROSNAHAN: Good morning, Your Honor. Brian
08:04:18 9 Brosnahan for the plaintiffs.

08:04:20 10 THE COURT: Good morning.

08:04:21 11 MR. FOSTER: Good morning, Your Honor. Jacob
08:04:21 12 Foster for the plaintiffs.

08:04:22 13 THE COURT: Good morning.

08:04:22 14 MR. MARTENS: Good morning, Your Honor. Matthew
08:04:24 15 Martens for the defendant Life Insurance Company of the
08:04:24 16 Southwest.

08:04:24 17 THE COURT: Good morning.

08:04:25 18 MR. SHAPIRO: Good morning, Your Honor. Jonathan
08:04:28 19 Shapiro also for defendant LSW. And to my left at counsel
08:04:31 20 table is Elizabeth MacGowan, our representative.

08:04:35 21 THE COURT: Good morning.

08:04:36 22 Please be seated.

08:04:43 23 I received a marked-up copy of Exhibit 673, and I
08:04:50 24 guess I'm just a little slow today. I'm not sure who wants
08:04:54 25 what in or out. Some material is highlighted; some material

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08:04:57 1 is circled in red.

08:04:57 2 So could you --

08:04:58 3 MR. SHAPIRO: If I may attempt to decipher, Your
08:04:58 4 Honor, plaintiffs last evening sent to us essentially
08:05:03 5 designations as opposed to redactions. So the marking in
08:05:07 6 red is from the plaintiffs, and they circled in red what
08:05:11 7 they think should come in.

08:05:13 8 THE COURT: In?

08:05:13 9 MR. SHAPIRO: In. They did the reverse. They did
08:05:17 10 a designation as opposed to a redaction.

08:05:17 11 THE COURT: Okay.

08:05:18 12 MR. SHAPIRO: They designated what they think
08:05:18 13 should be allowed to be in the document published to the
08:05:23 14 jury by circling it in red. So, consistent with that
08:05:26 15 approach we added yellow to what we would like to see in.
08:05:32 16 So conversely, anything that's not in yellow or not in red
08:05:36 17 everyone agrees should be out.

08:05:38 18 THE COURT: Okay. Then I will read this and mark
08:05:40 19 it up accordingly.

08:05:44 20 MR. SHAPIRO: Thank you, Your Honor.

08:05:44 21 THE COURT: I received plaintiffs' brief in
08:05:48 22 opposition to the motion to decertify filed at 3:11 a.m. I
08:05:55 23 will be prepared to address that issue at the end of the day
08:05:58 24 when we take up that motion and any Rule 50(a) motions.

08:06:03 25 I also received a proposed curative instruction

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08:06:05 1 filed at 12:05 a.m. with regard to living benefits rider.

08:06:12 2 I don't know if you have seen that?

08:06:14 3 MR. MARTENS: I have talked about it with my team.

08:06:17 4 I guess that's the equivalent of seeing it in trial. I

08:06:21 5 think the short answer is, as the Court knows, we continue

08:06:24 6 to believe that we should be able to discuss that topic. I

08:06:26 7 understand the Court's ruling. So having stated my

08:06:29 8 objection, I don't have a problem with a curative

08:06:32 9 instruction.

08:06:33 10 THE COURT: Okay. Your objection is noted.

08:06:36 11 Do you want this as part of the jury instructions,

08:06:38 12 or do you want me to just give it orally?

08:06:41 13 MR. BROSNAHAN: I think it makes just as much

08:06:46 14 sense to have it as part of the instructions.

08:06:48 15 THE COURT: Okay. We can discuss Exhibit 557. I

08:06:49 16 received a separate filing with regard to Exhibit 557, filed

08:06:54 17 at 4:40 a.m. I want to hear you out on that. But my

08:07:02 18 inclination is to receive 557 with the instruction that I

08:07:06 19 drafted this morning, but we can talk about that later when

08:07:10 20 we get to the instructions generally.

08:07:14 21 Anything else while we're waiting for the juror?

08:07:17 22 MR. BROSNAHAN: I think the Court last night was
08:07:21 23 reviewing 398.

08:07:23 24 THE COURT: I'm going to exclude Exhibit 398.

08:07:26 25 It seems to me there is a difference between

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08:07:29 1 running Monte Carlos on a financial package which includes a
08:07:31 2 number of different components rather than just insurance
08:07:36 3 policies. So consistent with my ruling that evidence of a
08:07:38 4 Monte Carlo is relevant only as to insurance policies, I'm
08:07:43 5 excluding 398.

08:07:45 6 MR. BROSNAN: I take it the Court observed that
08:07:47 7 the assets to which the Monte Carlo analysis would be
08:07:49 8 subject included insurance policies.

08:07:52 9 THE COURT: Yes. It was part of the bundle, but
08:07:55 10 it wasn't insurance policies only.

08:07:59 11 MR. BROSNAN: I understand the Court's ruling.

08:08:01 12 THE COURT: Okay.

08:08:01 13 MR. BROSNAN: Thank you, Your Honor.

08:08:04 14 MR. MARTENS: Did the Court -- I wasn't clear.
08:08:04 15 Did the Court say that you wanted to hear us on Exhibit 557
08:08:12 16 or -- because I would like to be heard on not only the
08:08:15 17 instruction but on the exhibit, if I could.

08:08:18 18 THE COURT: Fine.

08:08:19 19 MR. MARTENS: I think the issue, Your Honor, is
08:08:20 20 that I don't believe the financial statements of the
08:08:24 21 consolidated company are relevant under California law.

08:08:28 22 THE COURT: I agree.

08:08:29 23 MR. MARTENS: So I would be concerned that if
08:08:32 24 these statements come in, we are going to hear argument
08:08:35 25 about them in closing, which would be improper. I think

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08:08:38 1 California law is very clear in Tomaselli versus
08:08:44 2 Transamerica, 1994, that consolidated financial statement
08:08:48 3 for a parent insurance company is not evidence as to the
08:08:50 4 financial condition of the subsidiary.

08:08:52 5 So I think allowing that in when it, under
08:08:57 6 California substantive law, doesn't satisfy the element
08:09:00 7 would be improper.

08:09:02 8 THE COURT: Have you seen the curative instruction
08:09:04 9 that was handed out this morning?

08:09:07 10 MR. MARTENS: Not yet. My team did but I didn't.

08:09:25 11 THE COURT: Okay.

08:09:25 12 MR. MARTENS: I think I still have a concern, Your
08:09:26 13 Honor, because the Tomaselli case I think excludes it. The
08:09:34 14 Court allows it, you say, in the proposed instruction, and
08:09:37 15 you use it to the extent it assists you in arriving at a
08:09:39 16 reasonable of LSW's financial activities in California. I
08:09:45 17 don't think it does that. I don't think it can do that
08:09:47 18 combined with any other evidence.

08:09:49 19 THE COURT: Well, you can argue that. But it
08:09:52 20 seems to me, particularly given the course of conduct and
08:09:56 21 pointing the plaintiffs to LSW's website from which this
08:10:04 22 comes, it casts it in a different light. But for that, I
08:10:10 23 might have a different view.

08:10:12 24 There is at least some evidence of what portion of
08:10:14 25 National's business is attributable to LSW in California.

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08:10:18 1 It may be very thin evidence, but given the course of
08:10:22 2 dealings, I'm not going to rely on the general principle
08:10:25 3 that -- which I agree is a correct statement of law that a
08:10:29 4 parent's financials cannot come in when a defendant is the
08:10:34 5 subsidiary. But in the context of this case, with a
08:10:39 6 limiting instruction I believe that I honor the general
08:10:42 7 principle but allowing the jury to make such use as it may
08:10:47 8 for a relevant purpose.

08:10:54 9 MR. MARTENS: If I could just state one other
08:10:54 10 response to that at least for the record.

08:10:54 11 THE COURT: Sure.

08:10:56 12 MR. MARTENS: In Adams versus Murakami, a
08:10:58 13 California case from 1991, the Court ruled that because the
08:11:04 14 punitive damages requirement of the financial condition of
08:11:07 15 the defendant is an issue that's in the public interest,
08:11:12 16 that the public interest cannot allow this to be forwarded
08:11:16 17 by the defendant's tactics.

08:11:21 18 In other words, if the defendant's tactics,
08:11:21 19 whether at trial or otherwise, can't be a basis for allowing
08:11:25 20 such evidence that would otherwise be insufficient to
08:11:27 21 satisfy the standard.

08:11:28 22 So I would just respond that even if we had done
08:11:32 23 something inappropriate during discovery -- I don't believe
08:11:35 24 we have. But even if we had, I believe the case law is that
08:11:38 25 that doesn't change the analysis.

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08:11:40 1 THE COURT: I think the curative instruction that
08:11:43 2 I plan to give solves that. The jury could well find, you
08:11:49 3 now, one, they're instructed you can't base a punitive award
08:11:55 4 on the parent's financial condition.

08:11:57 5 Two, you can only use this to the extent it
08:11:59 6 informs you about the relevant corporate entity; namely,
08:12:02 7 LSW. It may tell them nothing; it may tell them something.
08:12:05 8 But I think that is to be argued to the jury.

08:12:09 9 MR. MARTENS: In that regard, Your Honor, with
08:12:12 10 regard to that instruction, then would the Court be willing
08:12:14 11 to instruct as to what California law does require; namely,
08:12:16 12 that they must prove LSW's financial condition before the
08:12:20 13 jury could award a punitive damages award? -- because I do
08:12:25 14 believe that's what the law requires.

08:12:28 15 THE COURT: That's in the basic instruction.

08:12:31 16 MR. MARTENS: I think it's identified as a factor,
08:12:32 17 but California law actually makes it more than a factor.
08:12:35 18 They must affirmatively prove our financial condition before
08:12:41 19 punitive damages could be awarded. So it is a factor, but
08:12:44 20 it's also a prerequisite that they must prove our financial
08:12:47 21 condition, and then that condition can be taken into
08:12:49 22 account. I think the instructions need to make that clear.

08:12:53 23 THE COURT: What is your authority for that?

08:12:55 24 MR. MARTENS: My authority for that, if the Court
08:12:59 25 will give me a second --

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08:13:01 1 THE COURT: Or I should say: Who is your
08:13:03 2 authority for that?

08:13:04 3 MR. MARTENS: Well, it's not me. It's the case
08:13:08 4 law. I believe it's the Adams versus Murakami case.

08:13:15 5 THE COURT: And the cite again, please.

08:13:17 6 MR. MARTENS: Yes -- 54 Cal.3d, 105, pinpoint site
08:13:23 7 119.

08:13:24 8 There is also a Ninth Circuit case that I know I
08:13:28 9 have. I can get it if the Court will --

08:13:35 10 THE COURT: Let me look at Murakami first.

08:13:39 11 MR. MARTENS: Thank you.

08:13:40 12 MR. BROSNAHAN: Your Honor, if I may, I would like
08:13:41 13 to take a look at the Adams case as well. I just want to
08:13:45 14 observe that. Although we're not trying to pierce the
08:13:48 15 corporate veil here, effectively they have ignored corporate
08:13:52 16 distinctions throughout the case.

08:13:53 17 THE COURT: We are not going to get to that issue
08:13:55 18 at this point.

08:13:56 19 MR. BROSNAHAN: I just want to make one other
08:13:56 20 observation. When I tried to ask whether each corporation
08:14:01 21 was -- whether any of the companies had liability for any of
08:14:05 22 the other companies, they objected on relevance grounds and
08:14:08 23 it was sustained.

08:14:09 24 So I don't know how they can take the position
08:14:13 25 that a question like that is irrelevant while at the same

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08:14:17 1 time saying no, each company has to be regarded separately.

08:14:22 2 THE COURT: Okay.

08:14:22 3 MR. BROSNAHAN: Thank you.

08:14:23 4 THE COURT: I'm advised the jury is up here, so
08:14:27 5 are we ready for the jury?

08:14:33 6 Bring the jury in, please.

08:14:34 7 (Jury present)

08:15:25 8 THE COURT: Good morning, ladies and gentlemen.

08:15:28 9 We will resume with our video deposition.

08:15:31 10 (Portion of videotaped deposition of

08:15:37 11 Michael Tivilini continued to be played)

08:48:37 12 MR. BROSNAHAN: That concludes the video, Your
08:48:38 13 Honor.

08:48:39 14 THE COURT: Okay.

08:48:39 15 MR. BROSNAHAN: At this point we would like to
08:48:43 16 publish from Exhibit 312, which is in evidence.

08:48:49 17 At the top we see the to and the from -- we will
08:48:58 18 move to the text in a moment -- from Michael Tivilini to
08:49:02 19 Mehran Assadi. And then further down in the text in the
08:49:02 20 second paragraph it says: Provider was priced to generate
08:49:15 21 an ROI equal to 12.7 percent. Favorable experience,
08:49:20 22 primarily a larger-than-expected average policy size, and a
08:49:27 23 favorable refinement to the company's reserving methodology
08:49:32 24 have enhanced the product's profitability. Our baseline
08:49:37 25 pricing models now suggest an ROI in excess of 17 percent.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

08:49:45 1 Then we would like also, Your Honor, to publish
08:49:47 2 from Exhibit 131, policies. If we could blow that up
08:49:57 3 perhaps a bit. It's the list of policies in the class. I
08:50:08 4 just want to publish ten of them. First one, policy
08:50:10 5 LS0175235, Enrique Baldonado; policy status is lapsed.
08:50:11 6 Secure-Plus Paragon gross premium, \$334,200.

08:50:28 7 Next, LS0179036, Jose Lopez; status, lapsed;
08:50:34 8 SecurePlus Paragon; gross premium, \$300,000. Then policy
08:50:40 9 number LS0189466, Depal Juananukawate; policy status,
08:50:51 10 lapsed; SecurePlus Paragon; gross premium, \$252,304.

08:50:59 11 Then LS0229373, Mosha Barkot; policy status,
08:51:02 12 lapsed; SecurePlus Paragon, gross premium \$219,400; and
08:51:17 13 LS0217797, Donald P. Pakosch; status, lapsed; SecurePlus
08:51:26 14 Paragon; gross premium, \$210,350.

08:51:29 15 Then LS0139718, Rick K. Smith; policy status,
08:51:39 16 lapsed; SecurePlus Provider; gross premium, \$135,274.48.

08:51:50 17 Then LS0131420, Eric Parks; policy status, lapsed;
08:52:01 18 SecurePlus Provider; gross premium, \$123,500.

08:52:10 19 Next, LS0159152, Stacey Fialcof; policy status,
08:52:13 20 lapsed; SecurePlus Paragon; gross premium, \$120,000. Policy
08:52:13 21 number LS0136604, Charles M. Burton; policy status, lapsed;
08:52:13 22 SecurePlus Provider; gross premium, \$120,000. Then policy
08:52:20 23 number LS0152071, Joy Compos; policy status, lapsed;
08:52:42 24 SecurePlus Paragon; gross premium, \$110,000.

08:52:57 25 With that, Your Honor, the plaintiffs will rest.

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08:53:00 1 THE COURT: Very good.

08:53:01 2 MR. BROSNAHAN: Thank you.

08:53:02 3 THE COURT: Mr. Martens.

08:53:04 4 MR. MARTENS: We would make our motion under

08:53:06 5 50(a).

08:53:08 6 THE COURT: Your motion will be deemed to be made

08:53:09 7 at this time. We will take it up later.

08:53:13 8 MR. MARTENS: Thank you, Your Honor.

08:53:15 9 Mr. Shapiro is going to call the next witness.

08:53:37 10 MR. SHAPIRO: Your Honor, to use the time

08:53:38 11 efficiently, before we take the witness takes the stand may

08:53:44 12 we be heard at sidebar for an offer of proof?

08:53:47 13 THE COURT: Sure.

08:53:47 14 (Sidebar conference)

08:56:25 15 MR. SHAPIRO: Jeffrey Stemler was the same agent

08:56:26 16 for Ms. Walker. Yesterday during cross-examination of

08:56:27 17 Mr. DeSantos, plaintiff elicited repeatedly testimony about

08:56:29 18 whether there would be a purpose in selling the Provider or

08:56:30 19 Paragon policy if there wasn't a need for a death benefit.

08:56:31 20 If asked why he sold a \$2.5 million death benefit policy to

08:56:34 21 Ms. Walker who was engaged but single at the time -- if

08:56:35 22 allowed to testify, I believe Mr. Stemler would say, No. 1,

08:56:36 23 cash accumulation or for tax-free retirement; No. 2, an

08:56:37 24 expressed need for living benefits. It's all over the

08:56:38 25 documents. We understand Your Honor's ruling. We are not

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08:56:42 1 trying to relitigate it.

08:56:43 2 THE COURT: But you are saying apart from the
08:56:43 3 rider?

08:56:44 4 MR. SHAPIRO: Long-term living benefit features.
08:56:45 5 We are not asking to go into the topic, but we don't want a
08:56:46 6 witness to be impeached --

08:56:48 7 MR. FOSTER: We don't plan to ask him any
08:56:49 8 questions on that in terms of the size of the death benefit,
08:56:50 9 Your Honor.

08:56:51 10 THE COURT: Okay. If you open up, we can come
08:56:51 11 back to it.

08:56:51 12 (End of sidebar conference)

08:56:51 13 THE COURT: Call your next witness.

08:56:51 14 JEFFREY STEMLER, DEFENDANT'S WITNESS, SWORN

08:56:53 15 THE CLERK: Please state your full name and spell
08:56:53 16 your last name for the record.

08:57:06 17 THE WITNESS: Jeffrey Stemler, S-t-e-m-l-e-r.

08:57:11 18 THE COURT: Mr. Shapiro.

08:57:12 19 DIRECT EXAMINATION

08:57:13 20 BY MR. SHAPIRO:

08:57:14 21 Q Good morning, Mr. Stemler.

08:57:15 22 A Good morning.

08:57:16 23 Q What do you do for a living?

08:57:18 24 A Financial planner.

08:57:18 25 Q How long have you been a financial planner?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

08:57:20 1 A It's going to be 47 years.

08:57:22 2 Q In your 47 years as a financial planner, is this the

08:57:25 3 first time you have testified in court?

08:57:27 4 A Yes.

08:57:28 5 Q Have you ever been sued, sir?

08:57:29 6 A No.

08:57:30 7 Q Have you ever sued anyone before?

08:57:31 8 A No.

08:57:33 9 Q So this is all new for you?

08:57:34 10 A Yes.

08:57:35 11 Q Did you sell a life insurance policy to Joyce Walker?

08:57:38 12 A Yes.

08:57:40 13 Q Near as you know, Mr. Stemler, is it that sale of that

08:57:43 14 life insurance policy to Joyce Walker that brings us all

08:57:46 15 here together?

08:57:47 16 A Yes.

08:57:47 17 Q We can go through it a bit later. But just to sort of

08:57:51 18 get it out there, number one, did you deceive Ms. Walker in

08:57:54 19 any way?

08:57:55 20 A No.

08:57:55 21 Q Did you mislead Ms. Walker in any way?

08:57:58 22 A No.

08:57:59 23 Q Did you conceal anything in any way, shape, or form

08:58:02 24 from Ms. Walker?

08:58:04 25 A No.

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08:58:04 1 Q Are you aware of anyone on the planet who deceived,
08:58:08 2 concealed, or lied to Ms. Walker?
08:58:10 3 A No.
08:58:10 4 Q Is it fair to say, sir, that you have been waiting five
08:58:13 5 years to be able to say that in open court?
08:58:16 6 A Yes.
08:58:17 7 Q Did you go to college?
08:58:17 8 A Yes.
08:58:18 9 Q Where, sir?
08:58:18 10 A Kent State.
08:58:20 11 Q Did you obtain a degree?
08:58:22 12 A Yes.
08:58:22 13 Q What was your degree in?
08:58:24 14 A Bachelor of business administration.
08:58:26 15 Q What year did you obtain that degree?
08:58:29 16 A 1969.
08:58:30 17 Q After you graduated from Kent State, did you have
08:58:33 18 occasion to obtain some professional certifications or
08:58:37 19 designations?
08:58:38 20 A Yes.
08:58:38 21 Q What were those, sir?
08:58:38 22 A I'm a chartered financial consultant, chartered life
08:58:44 23 underwriter, chartered property and casualty underwriter, a
08:58:46 24 CFP, and a certified exit planner.
08:58:53 25 Q So in order to obtain those certifications or

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08:58:53 1 designations, did you need to pursue some education or take
08:58:59 2 some courses?

08:59:00 3 A Yes.

08:59:00 4 Q What sort of training did you get to be able to hold
08:59:04 5 those designations?

08:59:05 6 A Each of those was ten courses. Several had final
08:59:11 7 exams. Others there were ten exams, and two I had to
08:59:14 8 produce full-blown exit plans for business owners.

08:59:19 9 Q So if I'm hearing you right, those certifications or
08:59:22 10 designations required ten courses?

08:59:26 11 A Yes.

08:59:27 12 Q And any number of exams?

08:59:29 13 A Yes.

08:59:29 14 Q So once you take all those courses and pass all those
08:59:33 15 exams, are there any ongoing or continuing education
08:59:36 16 requirements?

08:59:36 17 A Yes.

08:59:37 18 Q Have you maintained your currency with those?

08:59:40 19 A Yes.

08:59:40 20 Q Do any of those designations bring with them a
08:59:44 21 professional code of conduct?

08:59:46 22 A Essentially they all have some form, yes.

08:59:48 23 Q Does code of conduct govern how you need to behave and
08:59:52 24 comport yourself to live up to professional obligations?

08:59:55 25 A Yes. Boil it down to two. One is: Always put the

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09:00:00 1 interests of the client first. And based on the fact and
09:00:04 2 circumstance, what would you do for yourself.
09:00:07 3 Q Always put your client ahead of yourself?
09:00:09 4 A Yes.
09:00:09 5 Q Would you do for them what you would do for yourself?
09:00:12 6 A Yes.
09:00:13 7 Q Now, in terms of both of those, did you always put
09:00:16 8 Ms. Walker first?
09:00:18 9 A Yes.
09:00:18 10 Q Did you recommend or give any advice to Mr. Walker that
09:00:22 11 you wouldn't recommend or give to yourself?
09:00:23 12 A No.
09:00:24 13 Q Or a loved one?
09:00:25 14 A No.
09:00:25 15 Q And there is no doubt in your mind about that, sir?
09:00:30 16 A Correct.
09:00:31 17 Q Do you own an indexed universal life policy?
09:00:34 18 A No.
09:00:35 19 Q Is there a reason?
09:00:35 20 A Because the money I wanted to put into that I couldn't
09:00:37 21 because it's inside my qualified plans. So I bought indexed
09:00:44 22 annuities.
09:00:44 23 Q Is it the case that the indexed annuities have indexing
09:00:44 24 strategies, if you will, that are similar to the cash
09:00:51 25 accumulation features of the universal life policy?

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09:00:54 1 A They're identical.

09:00:56 2 Q Putting aside your own personal circumstances about the

09:00:58 3 qualified money, would you have any hesitance at all in

09:01:02 4 purchasing an indexed universal life for yourself?

09:01:05 5 A No.

09:01:06 6 Q Or recommending it to a loved one?

09:01:08 7 A No. I have.

09:01:09 8 Q Okay. Over the course of your career of 47 odd years,

09:01:14 9 have you worked for insurance companies?

09:01:16 10 A Yes.

09:01:17 11 Q What insurance companies have you worked for,

09:01:18 12 Mr. Stemler?

09:01:20 13 A Fidelity Mutual, New York Life, and Lincoln Financial.

09:01:23 14 Q And for those insurance companies, you actually

09:01:26 15 directly worked for them as an employee?

09:01:28 16 A Correct.

09:01:28 17 Q So in addition to the work you did directly for those

09:01:32 18 insurance companies -- New York Life, Lincoln, and the

09:01:35 19 others -- have you over the years been an appointed

09:01:39 20 insurance agent for life insurance companies?

09:01:42 21 A Yes.

09:01:43 22 Q Can you ballpark how many life insurance companies over

09:01:46 23 the years you have served as an agent?

09:01:48 24 A Probably around 30.

09:01:50 25 Q Do you consider yourself an independent agent?

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09:01:52 1 A Yes.

09:01:53 2 Q Could you just tell the jury what an independent agent

09:01:55 3 is.

09:01:56 4 A We do not work for a specific insurance company. We

09:01:59 5 have licenses with many companies, so we have choices.

09:02:04 6 Q And, in fact, do you present different competitive

09:02:07 7 products to your clients from different carriers?

09:02:09 8 A Yes.

09:02:10 9 Q You are not wed to LSW or anyone in particular?

09:02:13 10 A No.

09:02:13 11 Q That's what it means to be independent?

09:02:16 12 A Yes.

09:02:16 13 Q So in addition to LSW, putting LSW aside, today are you

09:02:19 14 appointed as an independent agent for other carriers?

09:02:23 15 A Yes.

09:02:23 16 Q Can you just name a couple of them.

09:02:25 17 A Allianz, EquiTrust.

09:02:25 18 Q So when you're working with a client for financial

09:02:33 19 planning, is there a certain approach that you personally

09:02:35 20 take to that client relationship?

09:02:38 21 A Yes. We use the CFP model for planning. You first

09:02:43 22 have a meeting to understand about their personal

09:02:47 23 circumstance, know them as a person. Then we move to what

09:02:53 24 are the financial goals they are trying to achieve. We then

09:02:58 25 collect financial information; also, questionnaires filled

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09:03:02 1 out and financial information.

09:03:05 2 Once we have that, we will do an analysis to see
09:03:07 3 if what they already have in place actually gets them to
09:03:12 4 where they want to be. If it doesn't, then we make
09:03:16 5 recommendations to change the mix or whatever we are going
09:03:19 6 to do. And then obviously if they decide to move forward,
09:03:24 7 we then place the product to enact the plan.

09:03:28 8 Q So that whole multi-step process that you just
09:03:32 9 described, I thought you said it was the approach that is
09:03:35 10 embraced by the CFP?

09:03:41 11 A Yes.

09:03:42 12 Q And that's the certified --

09:03:43 13 A Certified financial planning.

09:03:44 14 Q And this is a multi-step approach that you take in
09:03:44 15 working with each individual client?

09:03:44 16 A Yes.

09:03:44 17 Q Could you give the jury just a sense of how long that
09:03:48 18 whole process takes, you know, in a typical case -- if there
09:03:52 19 is one.

09:03:54 20 A At a minimum we are talking three to five meetings,
09:03:57 21 because they run about an hour each. And in some cases it's
09:04:04 22 much long -- 10, 12 meetings, depending on the complexity.

09:04:10 23 Q When you say three to five meetings, these are
09:04:10 24 in-person counseling sessions, if you will?

09:04:13 25 A Yes.

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09:04:14 1 Q Are there typically phone calls or other communications
09:04:16 2 or homework between the meetings?
09:04:18 3 A Yes.
09:04:21 4 Q You are familiar with the LSW Provider policy?
09:04:24 5 A Yes.
09:04:25 6 Q Was Provider the policy that you sold eventually to
09:04:28 7 Ms. Walker?
09:04:29 8 A Yes.
09:04:29 9 Q Did you follow the same approach to Ms. Walker that you
09:04:34 10 just described under the CFP approach?
09:04:37 11 A Yes.
09:04:38 12 Q Do you remember when you first met her?
09:04:41 13 A The first time I met her was probably, that I remember,
09:04:44 14 in November.
09:04:46 15 Q Of two thousand and --
09:04:50 16 A 2007, I think.
09:04:51 17 Q It's been a while?
09:04:52 18 A Yes.
09:04:53 19 Q Now, the Provider policy is an indexed universal life
09:04:56 20 policy?
09:04:57 21 A Yes.
09:04:58 22 Q Are you familiar with indexed universal policies other
09:05:01 23 than the LSW Provider?
09:05:02 24 A Yes.
09:05:03 25 Q Is the LSW Provider indexed universal life policy

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:05:07 1 similar to other indexed universal life policies?

09:05:11 2 A Yes.

09:05:12 3 Q In what ways is Provider similar to the competition?

09:05:16 4 A The basic chassis, the structure of the contract, is a
09:05:20 5 universal life contract that has variable premium choices
09:05:27 6 and face amounts and things of that nature. It has an
09:05:32 7 indexing crediting method, and all of them have exactly that
09:05:38 8 structure.

09:05:38 9 Q So all IULs with which you are familiar have flexible
09:05:44 10 premiums?

09:05:45 11 A Yes.

09:05:45 12 Q Have indexed crediting methods?

09:05:48 13 A Yes.

09:05:48 14 Q Do the IULs with which you are familiar typically have
09:05:51 15 the ability to take out loans?

09:05:53 16 A Yes.

09:05:54 17 Q The ability to take out loans, by the way, is that
09:05:56 18 unique to an IUL?

09:05:58 19 A No.

09:05:58 20 Q Can you take loans out of a universal life policy?

09:06:01 21 A Yes.

09:06:02 22 Q How about a whole life policy?

09:06:04 23 A Yes.

09:06:04 24 Q So all permanent insurance products allow you to take
09:06:08 25 loans?

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09:06:09 1 A Yes.

09:06:09 2 Q The tax protected features of those loans, are they any

09:06:14 3 different, sir, for an IUL policy than a universal life

09:06:14 4 policy?

09:06:17 5 A No.

09:06:17 6 Q Any different for a whole life policy?

09:06:20 7 A No.

09:06:28 8 Q Under some circumstances can a Provider policy lapse?

09:06:34 9 A Yes.

09:06:36 10 Q When I ask you lapse, what's your definition of lapse?

09:06:39 11 A It means that it's no longer in existence. It's gone

09:06:43 12 away.

09:06:44 13 Q Terminated?

09:06:45 14 A Could be.

09:06:46 15 Q In your experience, sir, what would lead a universal

09:06:49 16 life policy to lapse?

09:06:53 17 A If somebody stopped paying premium and the cost of the

09:06:58 18 insurance is still being deducted, so at some point it would

09:07:02 19 run out. If somebody voluntarily just surrenders it. And

09:07:07 20 then if you take too much money out, whether it's through

09:07:09 21 withdrawals or loans, it can cause it to terminate.

09:07:13 22 Q So if I heard you correctly, a policy terminates if

09:07:17 23 someone voluntarily surrenders it? Yes, sir?

09:07:20 24 A Yes.

09:07:20 25 Q So putting that aside, in terms of the lapse I thought

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09:07:24 1 you said, number one, don't pay enough premiums?

09:07:27 2 A Correct.

09:07:28 3 Q Number two, take too much out in terms of loans and
09:07:31 4 withdrawals?

09:07:31 5 A Correct.

09:07:32 6 Q In terms of those two causes of lapse, is the Provider
09:07:35 7 policy in any way different than any other IUL with which
09:07:39 8 you are familiar?

09:07:40 9 A No.

09:07:42 10 Q In terms of those two items that can cause the lapse --
09:07:45 11 number one, not paying enough, and number two, taking too
09:07:49 12 much out -- is the Provider policy any different than any
09:07:53 13 universal life policy with which you are familiar?

09:07:56 14 A No.

09:07:57 15 Q It's just sort of standard across, what did you say,
09:07:59 16 the chassis of universal life?

09:08:01 17 A Correct.

09:08:03 18 Q Did LSW provide you with training about the Provider
09:08:06 19 policy?

09:08:07 20 A Yes.

09:08:08 21 Q What kind of training?

09:08:11 22 A Once we were introduced to it by the regional
09:08:14 23 representative, we liked it, and so we contracted with them
09:08:21 24 or asked them to send out trainers, and we had our agents
09:08:27 25 attend various training sessions.

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09:08:29 1 Q If I'm hearing right, you asked LSW for training and
09:08:32 2 LSW sent people to you?
09:08:33 3 A Yes.
09:08:34 4 Q To teach you about the product?
09:08:35 5 A Yes.
09:08:36 6 Q Have you ever asked for any training from LSW that you
09:08:41 7 didn't receive?
09:08:41 8 A No.
09:08:42 9 Q How does LSW's training sort of stack up against the
09:08:46 10 other insurance companies with which you have worked over
09:08:48 11 the years?
09:08:49 12 A Most of the companies are pretty accommodating, but
09:08:52 13 they have also been and they also maintain one of the
09:08:57 14 high-end planning divisions which most companies have
09:09:02 15 abandoned. So we like them a lot.
09:09:04 16 Q So LSW in some form offers a step up in terms of
09:09:10 17 training from your experience?
09:09:12 18 A Yes.
09:09:12 19 Q Now, does LSW require you to take training?
09:09:16 20 A Not that I know of.
09:09:17 21 Q Does LSW need to require you to take training?
09:09:19 22 A No.
09:09:20 23 Q Is that just part of the relationship?
09:09:22 24 A Yes.
09:09:23 25 Q Would you ever sell a product that you weren't sure you

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09:09:26 1 understood and had the proper training in?

09:09:28 2 A No.

09:09:28 3 Q Would you ever let anyone in any office or group that
09:09:31 4 you worked in sell a product with which the selling agent
09:09:34 5 wasn't sufficiently educated?

09:09:36 6 A We can't force them either, but we definitely provide
09:09:40 7 the training and expect them to attend.

09:09:46 8 Q That's part of your job, sir?

09:09:50 9 A Yes.

09:09:50 10 Q So if you met Joyce Walker in 2007, let me ask you a
09:09:52 11 tough one: Where?

09:09:55 12 A We put on public workshops on various topics. That
09:09:59 13 particular topic was the risk faced by boomers facing
09:10:05 14 retirement, which are different than faced by her parents,
09:10:09 15 because her parents had pensions and things of this nature.

09:10:14 16 We were trying to talk about the areas that really
09:10:17 17 could destroy a retirement, such as longevity, losses just
09:10:23 18 before you're retiring and during retirement, and taxes and
09:10:30 19 inflation. And, of course, the 800-pound gorilla is the
09:10:32 20 catastrophic cost of health care, the long-term care.

09:10:37 21 Q Sure. So if I'm hearing you right, you first met
09:10:40 22 Ms. Walker at a presentation or an educational program that
09:10:43 23 you presented?

09:10:44 24 A Yes.

09:10:44 25 Q Were there folks in the audience other than Ms. Walker?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:10:47 1 A Yes.

09:10:48 2 Q This wasn't one of those one-on-one counseling

09:10:51 3 sessions?

09:10:51 4 A No.

09:10:52 5 Q I think you said the program lasted, what?

09:10:54 6 A Just about an hour.

09:10:54 7 Q In this educational program did you talk about any

09:10:58 8 particular product?

09:10:59 9 A No.

09:10:59 10 Q So you didn't talk about LSW?

09:11:01 11 A No.

09:11:01 12 Q You didn't talk about indexed UL or whatever?

09:11:07 13 A No.

09:11:08 14 Q Did you talk any particular client or customer?

09:11:09 15 A No.

09:11:10 16 Q So it was sort of a group setting in which you reviewed

09:11:13 17 any number of other financial options?

09:11:15 18 A Yes.

09:11:16 19 Q At some point did Ms. Walker ask to have a follow-up

09:11:20 20 session with you and your colleagues?

09:11:21 21 A Yes.

09:11:23 22 Q If you would, sir -- oh, I almost forgot your binder.

09:11:38 23 MR. SHAPIRO: Your Honor, may I approach the

09:11:39 24 witness?

09:11:40 25 THE COURT: You may.

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09:11:40 1 BY MR. SHAPIRO:

09:11:51 2 Q Mr. Stemler, the court deputy has been kind enough to
09:11:57 3 hand you a binder which has your name on it. If you would
09:12:03 4 turn, please, to tab 867-C, and just tell me when you get
09:12:13 5 there.

09:12:14 6 A I'm there.

09:12:18 7 Q Okay.

09:12:32 8 Just looking, is Exhibit 867-C, which is at pages
09:12:37 9 63 through 65 of the exhibit, a response sheet completed by
09:12:42 10 Joyce Walker, listed in her maiden name?

09:12:48 11 A Yes.

09:12:49 12 MR. SHAPIRO: Your Honor, we would move into
09:12:50 13 evidence Exhibit 867-C, which is 867, pages 63 through 65 of
09:12:57 14 what had been marked for identification.

09:13:01 15 MR. FOSTER: No objection.

09:13:03 16 THE COURT: 867-C will be received.

09:13:05 17 MR. SHAPIRO: Thank you, Your Honor.

09:13:05 18 (Exhibit No. 867-C received in evidence)

09:13:05 19 BY MR. SHAPIRO:

09:13:05 20 Q Can you tell the jury what is 867-C.

09:13:24 21 A This is a response sheet that we pass out at the
09:13:27 22 workshop, and then it's turned in if they wish to go any
09:13:33 23 further and have an appointment.

09:13:34 24 Q So does Exhibit 867-C just ask some initial questions?

09:13:39 25 A Yes.

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09:13:42 1 Q Go to page 2. So Joyce Schmidtbauer, is that
09:13:49 2 Ms. Walker's maiden name?
09:13:53 3 A Yes.
09:13:54 4 Q Is it fair to say there's just some basic questions
09:13:54 5 here about financial planning objectives?
09:13:57 6 A Yes.
09:13:58 7 Q Is this an initial questionnaire that you use with your
09:14:00 8 clients?
09:14:00 9 A Yes.
09:14:01 10 Q Is it the case, sir, that as the relationship
09:14:03 11 continues, you ask for a greater level of detail?
09:14:08 12 A Of course.
09:14:09 13 Q If you would, sir, turn to what's marked as page 2, the
09:14:14 14 next page.
09:14:14 15 A Yes.
09:14:17 16 Q Do you see a question where it says: Knowing what you
09:14:22 17 know now, what would you have done differently with your
09:14:25 18 money?
09:14:25 19 A Yes.
09:14:26 20 Q Did Ms. Walker answer that question?
09:14:28 21 A Yes, she did.
09:14:29 22 Q What did she say?
09:14:31 23 A Move things out of bad stocks, et cetera, quicker.
09:14:34 24 Q Did you discuss with Ms. Walker at some point in time
09:14:37 25 her answer to that question?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:14:39 1 A Yes.

09:14:39 2 Q What was the discussion that you had with Ms. Walker
09:14:42 3 about moving things out of bad stocks quicker?

09:14:45 4 A She did not want to lose money in the stock market.

09:14:48 5 Q Did Ms. Walker express to you in some form of words
09:14:53 6 that she was concerned about losing principal?

09:14:56 7 A That's what happens when you lose money in the stock
09:14:58 8 market.

09:14:59 9 Q Okay. Did she identify that as one of her planning
09:15:04 10 goals?

09:15:04 11 A Yes.

09:15:05 12 Q So after you received 867-C, did you in fact or did
09:15:07 13 your office in fact set up a meeting with Ms. Walker?

09:15:10 14 A Yes.

09:15:10 15 Q What happened next in the relationship?

09:15:12 16 A Then the meeting, the first meeting, was scheduled. I
09:15:17 17 did this in tandem with Mike Botkin. Mike actually held the
09:15:23 18 first meeting.

09:15:24 19 Q So could you just tell the jury who is Mike Botkin and
09:15:28 20 what is his role in all of this?

09:15:30 21 A Mike Botkin owns the firm that's called Preservation
09:15:33 22 Financial. He was also a vice-president of asset marketing
09:15:40 23 systems, which I am also. When we do retail work with
09:15:45 24 clients or the public, the business runs through
09:15:49 25 Preservation Financial so that when it's completed, they

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09:15:53 1 would become clients of that firm.

09:15:55 2 Q So did Mr. Botkin have an initial meeting with
09:15:59 3 Ms. Walker?

09:16:01 4 A Yes.

09:16:01 5 Q In fact, did Mr. Botkin have more than one meeting with
09:16:05 6 Ms. Walker?

09:16:06 7 A Based on our log, it was three meetings he had with
09:16:10 8 her.

09:16:10 9 Q At some point did you also meet directly with
09:16:14 10 Ms. Walker?

09:16:15 11 A Yes.

09:16:15 12 Q Just so we have the chronology right, Ms. Walker
09:16:16 13 attends this program that you gave for education for a lot
09:16:19 14 of people; right?

09:16:20 15 A Correct.

09:16:20 16 Q And there is no discussion about LSW at that meeting?

09:16:24 17 A No.

09:16:24 18 Q And there is no discussion about Ms. Walker in
09:16:26 19 particular; right?

09:16:27 20 A No.

09:16:27 21 Q She fills in the form which we just saw and requests a
09:16:30 22 meeting?

09:16:31 23 A Yes.

09:16:31 24 Q And then she met on a number of occasions with
09:16:34 25 Mr. Botkin?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:16:35 1 A Yes.

09:16:36 2 Q At some point did you also become involved in
09:16:39 3 counseling her directly?

09:16:40 4 A Yes.

09:16:42 5 Q Why was it that you became involved after Mr. Botkin's
09:16:45 6 initial meeting?

09:16:47 7 A The way we structure the firm is we specialize in what
09:16:50 8 we do. Mike held the first meeting, which was really the
09:16:56 9 get-acquainted meeting and going over the response sheet.
09:17:00 10 Then once he took his notes, then he prepared for the second
09:17:05 11 meeting, which was to talk over some basic concepts and also
09:17:10 12 gather and present some of the results that we had from
09:17:14 13 collecting financial information.

09:17:18 14 At that point he presented several concepts, one
09:17:22 15 of them being the insurance. And then I believe it was at
09:17:27 16 the third meeting he walked through that in some detail.
09:17:33 17 And when the decision was made that we should explore the
09:17:38 18 insurance further, that's when he asked me to come in on, I
09:17:41 19 believe, the fourth meeting and go through the insurance
09:17:44 20 again but in depth.

09:17:46 21 Q At that point you continued to meet with Ms. Walker,
09:17:48 22 sometimes with Mr. Botkin and sometimes just the two of you,
09:17:52 23 you and Ms. Walker?

09:17:55 24 A Yes.

09:17:56 25 Q So sort of soup to nuts, how many meetings did you

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09:18:00 1 and/or Mr. Botkin have with Joyce Walker before you sold

09:18:03 2 Ms. Walker the Provider policy?

09:18:06 3 A If you include the workshop, it would have been five --
09:18:11 4 five meetings over four and a half months.

09:18:13 5 Q So five meetings over the course of four odd months
09:18:18 6 before the policy?

09:18:19 7 A Yes.

09:18:19 8 Q And then after the policy was issued, was there another
09:18:22 9 meeting?

09:18:22 10 A Yes.

09:18:23 11 Q In which you discussed the policy at the delivery?

09:18:29 12 A It's the delivery, yes.

09:18:31 13 Q So if I heard you right, you became more involved with
09:18:33 14 Ms. Walker after there was a decision to focus on a life
09:18:37 15 insurance option?

09:18:38 16 A Right, because we also proposed an annuity and another
09:18:43 17 option. And if she would have chosen the annuity, Mike
09:18:49 18 would have continued. That's his specialty. If it was the
09:18:52 19 life, that's why I got involved.

09:18:54 20 Q Is it fair to say that during the initial sessions with
09:18:56 21 Ms. Walker, there wasn't a preordained decision that she
09:19:01 22 would be a life insurance person?

09:19:05 23 A No.

09:19:05 24 Q What other options did you and Mike and your team
09:19:10 25 present to Ms. Walker other than life insurance?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:19:13 1 A For the qualified money we were looking at an indexed
09:19:15 2 annuity that had a special feature that provided a
09:19:20 3 guaranteed buildup and a guaranteed income, and you could
09:19:22 4 look up literally on the schedule and know five years from
09:19:27 5 now, 10 years from now, 20 years from now, exactly how much
09:19:30 6 would be there, what the income would be, and it would last
09:19:33 7 forever.

09:19:36 8 Then we started talking some alternative
09:19:39 9 investments like real estate investment trusts or something
09:19:43 10 like that that were not correlated to the market.

09:19:48 11 Q So if I'm hearing you right, you proposed an indexed
09:19:49 12 annuity option?

09:19:50 13 A Yes.

09:19:51 14 MR. FOSTER: Objection, Your Honor. Could we have
09:19:53 15 clarity as to who proposed these options, him or Mr. Botkin.

09:19:55 16 MR. SHAPIRO: I can lay a foundation if you like.

09:19:55 17 BY MR. SHAPIRO:

09:19:56 18 Q Sir, did you and Mr. Botkin work as a team?

09:19:58 19 A Yes.

09:19:59 20 Q Did you have meetings together with Mr. Botkin and
09:20:01 21 Ms. Walker?

09:20:02 22 A Yes.

09:20:03 23 Q During your meetings together with Ms. Walker, did you
09:20:06 24 review the plan as it was evolving with her?

09:20:11 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:20:11 1 Q At some point did she make a choice to go forward with
09:20:15 2 an indexed universal life policy?

09:20:19 3 A Yes.

09:20:20 4 Q Is it the case, sir, that during your meetings with
09:20:22 5 Ms. Walker you also talked about, as you just said, an
09:20:25 6 annuity option?

09:20:28 7 A The first time it was brought up, it was by Mike. He
09:20:32 8 and I had met to say, all right, what possible things could
09:20:34 9 we do. So it was, I believe, that second meeting or the
09:20:38 10 third meeting that he mentioned those.

09:20:42 11 When she made the decision to move forward with
09:20:47 12 the insurance, that's when I got involved. And it was later
09:20:52 13 that I got involved with the annuities again when she called
09:20:53 14 back.

09:20:55 15 MR. FOSTER: Move to strike on what Mr. Botkin
09:20:55 16 said, Your Honor. That's hearsay.

09:21:00 17 MR. SHAPIRO: I think I can clean it up, Your
09:21:00 18 Honor.

09:21:00 19 BY MR. SHAPIRO:

09:21:02 20 Q Without saying what Mr. Botkin said to Ms. Walker, did
09:21:07 21 you and Mr. Botkin together work on a financial plan as
09:21:10 22 colleagues for Ms. Walker?

09:21:13 23 A Yes.

09:21:13 24 Q Did that financial plan include a variety of options
09:21:16 25 other than life insurance?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:21:17 1 A Yes.

09:21:17 2 Q And one of them was the indexed annuity option?

09:21:22 3 A Yes.

09:21:22 4 Q What was Ms. Walker's reaction to the indexed annuity

09:21:25 5 option?

09:21:28 6 A It wasn't adverse. I wasn't there, so I can't tell you

09:21:32 7 why the decision was made to move with the life. But it

09:21:36 8 was.

09:21:37 9 Q At some point later on you did talk to her about an

09:21:39 10 annuity option?

09:21:41 11 A Yes.

09:21:41 12 Q So there was a decision to move forward with the life

09:21:44 13 option?

09:21:44 14 A Yes.

09:21:45 15 Q Is there any reason why you didn't recommend that

09:21:47 16 Ms. Walker just invest directly in the S&P 500?

09:21:50 17 A Because you can't.

09:21:51 18 Q Why not?

09:21:53 19 A It's an index, so you have to have a vehicle to get

09:21:58 20 into it.

09:21:59 21 Q Sure. So my question was imprecise. Is there any

09:22:03 22 reason why you didn't recommend that she just buy a mutual

09:22:07 23 fund?

09:22:08 24 A If we were trying to minimize the potential for loss of

09:22:14 25 principal, then that would not be an appropriate

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:22:16 1 recommendation.

09:22:17 2 Q Because that was one of her objectives that she
09:22:19 3 communicated to you?

09:22:20 4 A Lyes.

09:22:21 5 Q And something that would be a direct investment in the
09:22:23 6 market wouldn't achieve that?

09:22:25 7 A It ran the risk of losing substantial loss of
09:22:31 8 principal.

09:22:31 9 Q That is, going below zero?

09:22:34 10 A Yes.

09:22:36 11 Q If you would, sir, turn to Exhibit 774.

09:22:49 12 MR. SHAPIRO: Your Honor, we would move
09:22:50 13 Exhibit 774 into evidence.

09:22:52 14 I believe there is no objection.

09:22:56 15 MR. FOSTER: No objection.

09:22:56 16 THE COURT: 774 will be received.

09:22:59 17 MR. SHAPIRO: Thank you, Your Honor.

09:22:59 18 (Exhibit No. 774 received in evidence)

09:23:00 19 BY MR. SHAPIRO:

09:23:02 20 Q Second page -- third page. Mr. Stemler, do you
09:23:18 21 recognize what has been marked as Exhibit 774 on page 3 as a
09:23:22 22 drawing?

09:23:22 23 A Yes.

09:23:23 24 Q Is this a drawing that you did on the back of
09:23:26 25 Ms. Walker's illustration?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:23:29 1 A Yes.

09:23:29 2 Q Could you describe for the jury what you were trying to
09:23:31 3 convey when you drew this drawing, Exhibit 774, on the back
09:23:38 4 of her illustration.

09:23:40 5 A This is -- when we are sitting down talking about
09:23:45 6 insurance, we try to explain to the prospects exactly how
09:23:49 7 the insurance works. So this is part of our talk that we
09:23:54 8 give to explain how it works.

09:23:56 9 So this would be a build slide. This didn't just
09:24:00 10 start there. I drew a line on the bottom and I said: When
09:24:04 11 you buy insurance, there is a minimum amount that you must
09:24:08 12 pay for insurance to pay for the costs and put the policy in
09:24:14 13 force. And I drew the line and I wrote minimum, and I would
09:24:19 14 ask who do you think sets that price.

09:24:22 15 Some people will say: I don't know. Others:
09:24:26 16 Well, the insurance company. I go, yes, you're correct.
09:24:27 17 And I said: They have actuaries, and the actuaries, their
09:24:27 18 job is to figure out how much they need to collect for any
09:24:36 19 given amount based on the age of the person so that they can
09:24:39 20 cover the risk and also still make a profit.

09:24:43 21 I said: But there's another line that we need to
09:24:46 22 be concerned about, and then I draw the line up on top and I
09:24:50 23 put the max there. And I say this is the maximum you can
09:24:55 24 pay for a contract. I said: Do you know who sets that
09:25:00 25 limit? People will often say: Well, the insurance company;

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09:25:06 1 right? And I say: No. It's actually the government.

09:25:09 2 In the example we'll often say: Well, let's just
09:25:11 3 assume that this is \$500,000 that we are dealing with here
09:25:15 4 and the minimum premium is a thousand dollars and the
09:25:19 5 maximum premium is \$5,000. Why would anyone put \$5,000 into
09:25:27 6 a contract if you could buy the same amount of coverage for
09:25:30 7 only 1,000?

09:25:32 8 Well, the reason is because once you pay that
09:25:35 9 minimum premium, everything between there and the upper line
09:25:40 10 receives substantial benefits, both taxes and other benefits
09:25:45 11 in there. So that is -- so what we are trying to explain is
09:25:49 12 why would we use life insurance as an accumulation vehicle?
09:25:54 13 Why would we use life insurance as an income-generating
09:25:57 14 vehicle? How would that actually be achieved? And that's
09:26:02 15 what you see there.

09:26:04 16 Q So you did this drawing while you were in the room with
09:26:08 17 Ms. Walker?

09:26:09 18 A Yes.

09:26:10 19 Q And Mr. Botkin was there as well?

09:26:11 20 A I believe so on this one, yes.

09:26:12 21 Q And you did this on the back of the illustration?

09:26:14 22 A Yes.

09:26:14 23 Q Maybe just to take a step back just to be clear. The
09:26:17 24 meeting that you are describing with Ms. Walker and
09:26:21 25 Mr. Botkin in which you drew this illustration and in which

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09:26:24 1 you discussed it with her, was this the first time she had
09:26:28 2 been presented with that illustration?

09:26:30 3 A No. Mr. Botkin had done this illustration, I believe,
09:26:33 4 when he first brought up the concept in the second meeting.

09:26:38 5 Q So near as you now, Mr. Botkin had given Ms. Walker the
09:26:43 6 illustration. They had had discussion about it, and then
09:26:46 7 came back for a second meeting about the illustration?

09:26:49 8 A That's my understanding, yes.

09:26:50 9 Q So what you are describing is meeting number two about
09:26:53 10 the illustration?

09:26:54 11 A That's my understanding, yes.

09:26:55 12 Q Okay. And what you're describing in terms of the max
09:26:58 13 and the min, that's the permissible premium, the minimum
09:27:01 14 you've got to pay?

09:27:04 15 A Right. And then the MEC is a technical term that the
09:27:06 16 government uses. It's called modified endowment contract.
09:27:07 17 And if you put \$1 above that, then the tax benefits and a
09:27:17 18 lot of the other benefits evaporate and it's treated very
09:27:19 19 much like an annuity of an IRA for distribution.

09:27:22 20 Q And you discussed those tax consequence with Ms. Walker
09:27:25 21 in the room when your drew the diagram as well?

09:27:29 22 A That's the point of the diagram.

09:27:31 23 Q If you would, sir, turn to the next page.

09:27:33 24 A Uh-huh.

09:27:33 25 Q You are now in Exhibit 774, page 5?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:27:40 1 A Yes.

09:27:40 2 Q Do you recognize this handwriting?

09:27:42 3 A Yes.

09:27:43 4 Q Is this more handwriting on the back of Ms. Walker's

09:27:48 5 illustration?

09:27:48 6 A Yes.

09:27:49 7 Q It's yours?

09:27:50 8 A Yes.

09:27:50 9 Q All right. Are these notes that you made while you

09:27:52 10 were in the room with her?

09:27:53 11 A Yes.

09:27:54 12 Q Now, I recognize that I have taken away your pen. You

09:27:57 13 can't write all over the document here. But just understand

09:27:59 14 the dynamic. You were in the room writing these things

09:28:02 15 down?

09:28:03 16 A Yes.

09:28:03 17 Q And you're explaining to them just like you're

09:28:05 18 explaining them to us?

09:28:06 19 A Yes.

09:28:07 20 Q How long did this meeting go on for?

09:28:09 21 A It was certainly an hour, probably an hour and a half.

09:28:12 22 Q So it's you, Mr. Walker, and Mr. Botkin in the

09:28:16 23 conference room?

09:28:18 24 A Yes.

09:28:18 25 Q Did Ms. Walker ask questions of you during your

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09:28:20 1 meetings?

09:28:21 2 A Oh, yes.

09:28:21 3 Q Did she ask lots of questions?

09:28:25 4 A Not an inordinate amount, but she definitely asked

09:28:25 5 questions.

09:28:29 6 Q Do you have a memory of her coming to meetings prepared

09:28:29 7 with questions?

09:28:32 8 A Oh, yes.

09:28:33 9 Q Did you answer them?

09:28:33 10 A Well, this is part of answering some of the questions.

09:28:36 11 Q Is it your memory that some of the notes that are up on

09:28:39 12 the jumbotron here from Exhibit 774 were you answering

09:28:43 13 specific questions that she had posed to you?

09:28:45 14 A And I'm not sure if it was right at this meeting or

09:28:48 15 not, but I knew I wanted to walk through this so she had a

09:28:53 16 better understanding how it would actually work.

09:28:55 17 Q From time to time do clients ask you questions that you

09:28:58 18 can't answer?

09:28:59 19 A Yes.

09:29:00 20 Q What do you do if a client asks you questions that you

09:29:03 21 can't answer?

09:29:05 22 A That's a good question. I will find the answer.

09:29:06 23 Q And do you in fact find the answer?

09:29:06 24 A Yes.

09:29:06 25 Q But you don't have any memory of that being the case

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09:29:06 1 with Ms. Walker?

09:29:06 2 A No.

09:29:09 3 Q So just looking quickly at this document, do you see
09:29:13 4 where it stays basic stat? Does this refer to the basic
09:29:18 5 strategy?

09:29:19 6 A Yes.

09:29:19 7 Q Did you discuss the basic strategy with Ms. Walker?

09:29:22 8 A Yes.

09:29:23 9 Q Did you tell her that all premiums go in for, what, 30
09:29:28 10 days to the basic strategy?

09:29:29 11 A The premiums go into the basic strategy. And depending
09:29:34 12 on when -- it's called the sweep date. There is a date in a
09:29:38 13 month when they take the money out of the strategy and put
09:29:43 14 it into the index. If you get there a day after they're
09:29:45 15 done it, it's 30 days. If you get there a day before, it
09:29:49 16 will only be a day that it would sit in the basic strategy.

09:29:52 17 Q Did you explain that level of detail to Ms. Walker?

09:29:56 18 A Yes.

09:29:56 19 Q So maybe just moving down the page, do you see a
09:29:59 20 reference to number two, annual mortality costs?

09:30:02 21 A Yes.

09:30:02 22 Q Did you discuss the annual mortality costs of the
09:30:06 23 policy with Ms. Walker?

09:30:09 24 A This is hypothetical and generic, but the answer is
09:30:09 25 yes.

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09:30:10 1 Q When you say hypothetical and generic, you're saying
09:30:11 2 that the numbers that you put here aren't tied to her own
09:30:16 3 medical underwriting; right?
09:30:17 4 A Yes.
09:30:18 5 Q Because you didn't even know that at the time; right?
09:30:19 6 A Right.
09:30:20 7 Q But did you discuss with Ms. Walker that there were
09:30:22 8 mortality costs that would be assessed against her policy?
09:30:28 9 MR. FOSTER: Objection. Leading.
09:30:29 10 THE COURT: Rephrase.
09:30:29 11 MR. SHAPIRO: Fair enough.
09:30:29 12 BY MR. SHAPIRO:
09:30:30 13 Q Did you discuss that there would be mortality costs of
09:30:32 14 some amount that would be taxed against Ms. Walker's policy?
09:30:36 15 A That would come out of the policy, yes.
09:30:39 16 Q Did you explain that to her clearly, sir?
09:30:42 17 A That's what this was trying to illustrate.
09:30:44 18 Q In the lower right-hand corner there's more numbers.
09:30:45 19 There's a reference to a D.B. What does D.B. refer to?
09:30:51 20 A The death benefit.
09:30:52 21 Q And below that there is a reference to ACC?
09:30:55 22 A That's the accumulation amount that's inside the
09:30:58 23 contract.
09:30:58 24 Q Okay. So that would be like a hypothetical amount of a
09:31:01 25 cash value?

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09:31:02 1 A Correct.

09:31:02 2 Q And then below that is there something that says pure

09:31:06 3 D.B.?

09:31:07 4 A Yes.

09:31:08 5 Q And what is that, sir?

09:31:08 6 A If she died in this example, the heirs or the

09:31:11 7 beneficiaries would receive \$2 million, but \$500,000 of that

09:31:17 8 two million was actually cash. So what's being charged for

09:31:21 9 the coverage is the difference between the cash and the

09:31:24 10 death benefit, and that's the million five. As the cash

09:31:29 11 continues to grow, the amount of pure death benefit starts

09:31:34 12 to shrink and the cost goes down.

09:31:37 13 Q So just to make sure that I'm understanding you

09:31:40 14 correctly, are you referring to what sometimes is called the

09:31:43 15 net amount at risk?

09:31:45 16 A Yes.

09:31:45 17 Q Is the net amount at risk the amount upon which the

09:31:48 18 costs of insurance are calculated from time to time?

09:31:52 19 A Yes.

09:31:53 20 Q Did you explain that to Ms. Walker?

09:31:55 21 A Yes.

09:31:56 22 Q In that degree of detail?

09:31:59 23 A That's what the graphic was for, yes.

09:32:03 24 Q Turning now, if you will, Mr. Stemler, to Exhibit 781

09:32:09 25 which is already in evidence, and in particular to an

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09:32:14 1 illustration which I believe starts at page 20 of
09:32:18 2 Exhibit 781.

09:32:20 3 A Page 20 on the illustration?

09:32:30 4 Q Yes. It's the illustration. So it's 781, and there
09:32:31 5 will be, like, a .00, two zeros.

09:32:32 6 MR. FOSTER: Is that the October illustration?

09:32:47 7 MR. SHAPIRO: I think you introduced it into
09:32:48 8 evidence.

09:32:52 9 Is there one in yours, Your Honor?

09:32:56 10 It's the October illustration.

09:33:06 11 BY MR. SHAPIRO:

09:33:08 12 Q It's 781. Do you have it, Mr. Stemler?

09:33:13 13 A Which page?

09:33:14 14 Q Page 20.

09:33:16 15 MR. FOSTER: Actually we would object, Your Honor.
09:33:18 16 This is not a complete illustration. The illustration is in
09:33:21 17 the record at Exhibit 48.

09:33:28 18 MR. SHAPIRO: Your Honor, it's a complete
09:33:29 19 illustration, number one. Number two, it's been stapled in
09:33:33 20 the manner which it was produced. Number three, I believe
09:33:37 21 it was introduced on the 16th of the month.

09:33:40 22 THE COURT: Proceed.

09:33:40 23 MR. SHAPIRO: Thank you, Your Honor.

09:33:40 24 THE WITNESS: But is that 781-0039, and it would
09:33:40 25 be 20 or 21? Is that what you're talking about?

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09:33:40 1 BY MR. SHAPIRO:

09:33:41 2 Q 39 would be the last page.

09:33:53 3 A Right.

09:33:54 4 Q And then the first page would be 781-0020.

09:34:01 5 A Oh, okay. Got it.

09:34:06 6 Q As if the world weren't complicated enough, I
09:34:09 7 understand that the pages in the exhibit are out of order.

09:34:14 8 Do you recognize just the first page? Is this the
09:34:15 9 illustration that you and Mr. Botkin reviewed with
09:34:20 10 Ms. Walker during the meeting you have been describing?

09:34:23 11 A Yes.

09:34:25 12 Q If you would, sir, turn to page 11 of the illustration,
09:34:28 13 which is Exhibit 781-0030.

09:34:40 14 A Yes.

09:34:43 15 Q Can we agree, Mr. Stemler -- well, let me ask you this:
09:34:47 16 Is there lots of handwriting all over this page?

09:34:50 17 A Yes.

09:34:51 18 Q Is some of it yours?

09:34:55 19 A Yes.

09:34:55 20 Q In addition to doing the drawings and writing out the
09:34:55 21 information on the back of the illustration, when you
09:34:55 22 reviewed it with her, did you make notations?

09:34:58 23 A Yes.

09:34:58 24 Q Did you explain them to her?

09:35:00 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:35:00 1 Q And you recognize at least some of the handwriting on
09:35:02 2 the page as being yours?

09:35:04 3 A Yes.

09:35:04 4 Q When you reviewed the illustration with Ms. Walker, did
09:35:07 5 you discuss the planned premium payments that are in the
09:35:10 6 upper left-hand corner of the illustration?

09:35:13 7 A Yes.

09:35:15 8 Q What did you tell her?

09:35:16 9 A Well, based on the amount of money that she had set
09:35:20 10 aside for retirement and we were going to place in here, we
09:35:25 11 needed to divide it up into five installments so that it
09:35:31 12 would give the maximum benefit to her as opposed to putting
09:35:37 13 it in all at one time. So that's the premium payment right
09:35:42 14 there.

09:35:43 15 Q So this was a premium payment plan that you discussed
09:35:46 16 with Ms. Walker?

09:35:47 17 A Yes.

09:35:48 18 Q And that it would call for her to make planned premium
09:35:52 19 payments of \$112,637 for each of the first five years?

09:35:57 20 A Yes.

09:35:58 21 Q Now, just turning a little higher up on the page, is
09:36:00 22 there a paragraph that begins: This illustration of LSW
09:36:07 23 provider values?

09:36:08 24 A Yes.

09:36:08 25 Q So just focusing on the first sentence, did you tell

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09:36:11 1 Ms. Walker that her entire illustration assumed that she
09:36:15 2 actually made those five premium payments?
09:36:18 3 A Yeah. I mean, that's the whole point.
09:36:21 4 Q That's the whole point of the illustration? Yes, sir?
09:36:24 5 A Yes.
09:36:24 6 MR. FOSTER: Objection. Leading.
09:36:26 7 THE COURT: Overruled.
09:36:26 8 BY MR. SHAPIRO:
09:36:26 9 Q Did you express that in a clear form of words to her?
09:36:30 10 A Yes.
09:36:30 11 Q Recognizing that you don't know what's in anyone else's
09:36:35 12 head, in your own mind was there any doubt in your mind that
09:36:38 13 she understood?
09:36:39 14 A No, because we talked about the total amount that was
09:36:42 15 going to go in here and here's how we had to put it in.
09:36:47 16 Q This was a back-and-forth conversation?
09:36:48 17 A Yes.
09:36:49 18 Q So does the illustration that you reviewed with
09:36:51 19 Ms. Walker, Exhibit 781, does it provide or offer different
09:36:55 20 scenarios?
09:36:57 21 A Yes.
09:36:58 22 Q Is one of those scenarios the guaranteed scenario?
09:37:01 23 A Yes.
09:37:03 24 Q Are current basis A and current basis B two of the
09:37:07 25 other scenarios?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:37:08 1 A Yes.

09:37:09 2 Q Are current basis A and current basis B guaranteed or
09:37:12 3 non-guaranteed?

09:37:13 4 A They are non-guaranteed.

09:37:15 5 Q So just starting first with the guaranteed scenario or
09:37:17 6 guaranteed values?

09:37:19 7 A Yes.

09:37:19 8 Q Did you discuss the guaranteed values with Ms. Walker
09:37:23 9 as you reviewed the illustration with her?

09:37:26 10 A Yes.

09:37:26 11 Q What did you tell her?

09:37:30 12 A Well, first, the guarantees, the actual guarantee is
09:37:33 13 the worst case scenario. That means that the index has not
09:37:39 14 performed and that the highest possible expenses that could
09:37:42 15 be charged are reflected in that column. So it's the most
09:37:48 16 conservative. But the real message of that column is that
09:37:52 17 if that ever got invoked, there is a lot bigger problems in
09:37:56 18 the financial world than this contract.

09:38:00 19 Q So you discussed the guaranteed values in the context
09:38:02 20 of not just this illustration but also financial planning
09:38:05 21 overall?

09:38:05 22 A Right. And that this -- but this was, if you will, the
09:38:12 23 fail-safe. This was the bottom line what the company could
09:38:19 24 guarantee.

09:38:19 25 Q Did you discuss with Ms. Walker whether there was a

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09:38:22 1 certain annual floor for the LSW Provider policy?

09:38:27 2 A Yes.

09:38:28 3 Q What did you tell her?

09:38:29 4 A Well, it's an indexed product, and the way indexing
09:38:33 5 works is if the index goes up, you receive either all of it
09:38:38 6 or a portion of it. If the market or the index goes down
09:38:43 7 like it did the second year of 30 percent, that did not get
09:38:49 8 credited. She got credited zero. So it went up. If it
09:38:54 9 goes down, the worst that can happen is that you don't get
09:38:58 10 credited any interest, but you don't go negative.

09:39:02 11 Q So you never do worse than zero in any year?

09:39:05 12 A Correct.

09:39:06 13 Q Did you make clear to Ms. Walker that she wouldn't do
09:39:10 14 worse than zero in any year on an annual basis?

09:39:12 15 A Yes.

09:39:12 16 Q Mr. Stemler, the column says at the top guaranteed
09:39:16 17 values at two percent?

09:39:18 18 A Correct.

09:39:18 19 Q Did you explain to Ms. Walker what guaranteed values at
09:39:21 20 two percent mean?

09:39:22 21 A Yes. Actually we explained another thing, is that when
09:39:29 22 you put the premium in, this entire contract is based on
09:39:33 23 what they call five-year segments. So if you put money in
09:39:37 24 in year one, whatever crediting method you chose would be --
09:39:44 25 you would stay in that crediting method for that amount of

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09:39:47 1 money for five years. So that was important to understand.

09:39:51 2 Now, next year, year two, if you wanted to change
09:39:54 3 and go to a different crediting method, then that segment
09:39:58 4 would go in that bucket for five years. So in the context
09:40:02 5 of that, what this guarantee is trying to say is that, okay,
09:40:09 6 if in that -- let's just take the very first year -- you go
09:40:16 7 ahead and you put the money in there and over the next five
09:40:21 8 years, if the accumulation had not grown, if it had been
09:40:28 9 paid two percent every time and the amount was less than
09:40:33 10 that at the end of the five-year period, they would make up
09:40:38 11 the difference.

09:40:39 12 So, for example, under this scenario I believe it
09:40:43 13 would be accurate to say that if there was 446 was here?

09:40:49 14 Q Yes, the cash surrender value. You're looking at year
09:40:52 15 five?

09:40:53 16 A Yes.

09:40:53 17 Q That's the guarantee?

09:40:54 18 A Yes. The actual accumulation due to the indexing was
09:40:56 19 440, they would actually put in \$6,792 to true it up.

09:41:07 20 Q At cash surrender if they surrendered at that point in
09:41:10 21 the column?

09:41:11 22 A Yes.

09:41:12 23 Q Were you clear with Ms. Walker that the two percent
09:41:14 24 was, as you described, a five-year look back?

09:41:17 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:41:18 1 Q No doubt in your mind that you were clear about that?

09:41:21 2 A Yes.

09:41:21 3 Q If you will, sir, if you look to where it says annual

09:41:26 4 loan.

09:41:26 5 A Yes.

09:41:27 6 Q Am I right in seeing that there is an annual loan

09:41:31 7 amount listed of \$93,167 at year 15?

09:41:36 8 A Yes.

09:41:37 9 Q According to the illustration on the guaranteed basis,

09:41:40 10 what happens after the second year of that illustrated loan?

09:41:46 11 A The contract would terminate.

09:41:49 12 Q It would lapse?

09:41:50 13 A It would lapse.

09:41:51 14 Q Did you discuss with Ms. Walker that policies lapse if,

09:41:54 15 as you said before, not enough premiums are paid or too many

09:41:59 16 loans are taken?

09:42:00 17 A Yes.

09:42:00 18 Q Now, this \$93,167 loan that is illustrated, is that a

09:42:08 19 number that you came up with with Ms. Walker?

09:42:10 20 A No.

09:42:12 21 Q Is that a number that you promised her that she would

09:42:16 22 definitely be able to get?

09:42:18 23 A No.

09:42:18 24 Q What did you tell Ms. Walker about her ability to take

09:42:21 25 loans in the future from her policy?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:42:25 1 A That she could take loans in the future from her
09:42:28 2 policy.
09:42:29 3 Q Did you promise her that she would be able to take
09:42:31 4 loans in any particular amount?
09:42:33 5 A No.
09:42:34 6 Q Did you promise that she would be able to take loans in
09:42:34 7 any particular amount for any particular period of time?
09:42:38 8 A No.
09:42:38 9 Q Did you ever offer Ms. Walker a probability of her
09:42:42 10 ability to take loans?
09:42:44 11 A No.
09:42:45 12 Q Did you ever say it's sort of likely you will be able
09:42:47 13 to take loans?
09:42:48 14 A No.
09:42:53 15 Q Would you turn now to the current basis B values. Do
09:43:06 16 you see a column that says weighted average interest rate?
09:43:10 17 A Yes.
09:43:11 18 Q That looks like it's around seven percent?
09:43:14 19 A Correct.
09:43:15 20 Q Then in the upper right-hand corner -- well, now it's
09:43:18 21 in the left -- there is some handwriting that says index
09:43:21 22 five percent, seven percent. Do you see that writing?
09:43:24 23 A Yes.
09:43:25 24 Q Is that yours?
09:43:25 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:43:27 1 Q Did you make those notes while describing how current
09:43:31 2 basis B works for Ms. Walker?
09:43:33 3 A Yes.
09:43:33 4 Q What did you tell her?
09:43:34 5 A One of the features of the product we liked is it had a
09:43:36 6 140 percent participation rate. If the index actually only
09:43:41 7 went up five, the contract as it sat would actually credit
09:43:48 8 seven to the index rate. That would be the index rate. So
09:43:54 9 the index would actually go up five and the contract would
09:43:58 10 credit seven.
09:43:59 11 Q So you also discussed with Ms. Walker as you reviewed
09:44:03 12 the illustration not just how the guarantees work but how
09:44:05 13 participation rates work?
09:44:05 14 A Correct.
09:44:08 15 Q Participation rates guaranteed or non-guaranteed?
09:44:11 16 A They're non-guaranteed.
09:44:13 17 Q Did you tell her that as well?
09:44:14 18 A Yes.
09:44:15 19 Q So this weighted average interest rate of around seven
09:44:17 20 percent, was that a number that LSW dictated that you use
09:44:20 21 for this illustration?
09:44:22 22 A No.
09:44:23 23 Q Where did that number come from?
09:44:24 24 A The number we could have used would have been 7.5. We
09:44:29 25 just chose to back it down to be more conservative and we

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:44:33 1 dropped it down to seven.

09:44:35 2 Q So if I'm hearing you correctly -- and perhaps now turn
09:44:38 3 to page 9.

09:44:47 4 A Page 9.

09:44:48 5 Q I'm sorry. Page 9 of 21, which is Exhibit 781 on page
09:44:53 6 26.

09:45:03 7 A Which one is that now?

09:45:05 8 Q Page 26, 781, focusing on the paragraph beginning the
09:45:18 9 maximum illustration rate.

09:45:22 10 A Yes.

09:45:31 11 Q Is this what you were just referring to that the
09:45:33 12 company's maximum illustration rate was 7.5 percent?

09:45:37 13 A Yes.

09:45:37 14 Q But you chose not to illustrate with 7.5 percent?

09:45:41 15 A Correct.

09:45:42 16 Q You chose seven percent?

09:45:43 17 A Yes.

09:45:43 18 Q Was seven percent in any way, shape, or form correlated
09:45:48 19 to the past S&P?

09:45:50 20 A I'm not sure I understand the question.

09:45:52 21 Q Sure, sir. I thought your testimony was earlier that
09:45:55 22 the insurance company would have allowed you to illustrate
09:45:59 23 7.5 percent.

09:46:00 24 A Correct.

09:46:01 25 Q And you just chose to illustrate something lower?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:46:04 1 A Yes.

09:46:05 2 Q Did you discuss that with Ms. Walker?

09:46:08 3 A Yes.

09:46:10 4 Q What did you tell her about why you were choosing to

09:46:11 5 illustrate at seven percent even though the company would

09:46:16 6 have allowed you to do 7.5?

09:46:18 7 A It was just a more conservative assumption than going

09:46:22 8 with the maximum that we could have quoted.

09:46:25 9 Q Did you explain that clearly to Ms. Walker on why you

09:46:28 10 were doing that?

09:46:29 11 A I believe so.

09:46:30 12 Q As you know from how illustrations work, could you have

09:46:33 13 picked seven and a quarter?

09:46:36 14 A Yes.

09:46:36 15 Q Could you have picked 6.85?

09:46:39 16 A Yes.

09:46:40 17 Q Do you have any idea what other agents do with other

09:46:43 18 customers?

09:46:44 19 A The ones we teach, we tell them to do just what I have

09:46:48 20 outlined here. But some will go to the maximum.

09:46:50 21 Q So am I hearing you right that in your experience, what

09:46:52 22 you advise other agents in your group is to do something

09:46:57 23 more conservative than what the company would allow?

09:47:01 24 A Yes.

09:47:01 25 Q And to explain that to the client?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:47:03 1 A Yes.

09:47:04 2 Q Maybe go back to the illustration page, which is 11 of

09:47:08 3 21, 781-30. Did you in any way, shape, or form tell

09:47:22 4 Ms. Walker, Mr. Stemler, that she should assume that in the

09:47:26 5 future the S&P will return in a way that it had in the past?

09:47:33 6 A No, because you can't say that.

09:47:35 7 Q You can't say that, sir?

09:47:37 8 A No.

09:47:37 9 Q And you didn't say that?

09:47:38 10 A No.

09:47:39 11 Q Instead what did you tell her?

09:47:41 12 A That it was back tested and that, you know, past

09:47:48 13 performance is not a predictor of the future but it's all we

09:47:51 14 have to go on. So that was also part of the reason we

09:47:55 15 backed it down, because I don't know what's going to happen.

09:47:58 16 Q It was your judgment to illustrate something even more

09:48:02 17 conservative than what the company did because you don't

09:48:05 18 know what the future will hold?

09:48:07 19 A Right.

09:48:08 20 Q And you expressed that in a clear form of words to

09:48:12 21 Ms. Walker?

09:48:12 22 A Yes.

09:48:12 23 Q Now, before we leave the loans, did you ever discuss

09:48:15 24 with Ms. Walker any process by which you would determine

09:48:19 25 whether or not she would be able to take loans from her

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:48:22 1 policy?

09:48:24 2 A Well, the point here is when you get to the point where
09:48:27 3 it's time to take money out -- well, first off, the column
09:48:31 4 there with the weighted average, the main point of that is
09:48:38 5 that's not reality. That's never going to happen. Things
09:48:43 6 are going to go up and things are going to go down.

09:48:44 7 The use of that column, where it is useful, is it
09:48:44 8 becomes a barometer. So five years from now we can take a
09:48:53 9 look at what's really happened and see are we above the, if
09:48:54 10 you will, glide path or below it. When you get to the point
09:48:58 11 where it's time to take out loans, what we have to look at
09:49:01 12 there is specifically how much is in the contract at that
09:49:06 13 point in relation to what the illustration said. Then at
09:49:10 14 that point you actually have to start to manage how much you
09:49:16 15 take out of there so that you don't become in jeopardy.

09:49:20 16 Q So how do you work with clients as a barometer to
09:49:23 17 manage their policy and their finances?

09:49:27 18 A Well, the first thing when we start out with a brand
09:49:31 19 new contract, there is not really much -- I say let's not
09:49:36 20 get excited for about the first three years. We have got to
09:49:40 21 see if there is a trend, if there's anything going on.

09:49:42 22 But after that, then that's when we start to
09:49:46 23 either via phone at the anniversary or sit-down meetings
09:49:51 24 have conversations to see how much is in there versus what
09:49:55 25 we had hoped would be there.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:49:58 1 Q Is this a discussion you had with Ms. Walker?

09:50:00 2 A Yes.

09:50:00 3 Q Did you suggest that you and Ms. Walker meet on some
09:50:03 4 regular basis?

09:50:03 5 A Well, like I say, after about the first two to three
09:50:07 6 years, then it is imperative that we get together and take a
09:50:12 7 look at this thing at least once a year.

09:50:16 8 Q What would be the purpose of that annual checkup?

09:50:19 9 A Just to make sure are we ahead of the game or are we
09:50:23 10 behind the projections.

09:50:25 11 Q Is that something you would do with your clients?

09:50:28 12 A Yes.

09:50:28 13 Q Would you be doing that with Ms. Walker today had she
09:50:32 14 continued to pay?

09:50:33 15 A Yes.

09:50:34 16 Q At some point did Ms. Walker submit a life insurance
09:50:37 17 application?

09:50:37 18 A Yes.

09:50:38 19 Q If you would, sir, turn to Exhibit 784. It may say
09:50:41 20 784-R.

09:50:44 21 THE COURT: Before you do that, why don't we take
09:50:46 22 our first break of the day.

09:50:50 23 Ladies and gentlemen, we will be in recess for 15
09:50:50 24 minutes. Please remember the admonition.

09:51:00 25 (Jury not present)

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:51:16 1 MR. MARTENS: Your Honor, may I be heard on the
09:51:19 2 punitive damages issue again? I think it bears on our case
09:51:22 3 in particular now that I have had an opportunity to read
09:51:24 4 Mr. Brosnahan's motion.

09:51:27 5 In particular Mr. Brosnahan says that having put
09:51:31 6 in the information that they've put in, including these
09:51:34 7 financial statements of the parent company, the motion says
09:51:37 8 it is up to LSW to put in more specific numbers if it has
09:51:40 9 them and wishes to offer them.

09:51:43 10 THE COURT: That's an incorrect statement of the
09:51:44 11 law. McConney clearly says that's not the law and it would
09:51:50 12 be unfair if it were the law.

09:51:52 13 MR. MARTENS: That's what I wanted to point out,
09:51:53 14 because with regard to my Rule 50(a), as the case law
09:51:56 15 interprets Murakami going forward, I think it's clear that
09:51:56 16 they failed as a matter of law on their punitive damages
09:52:04 17 request. They have not put in a statement of our financial
09:52:07 18 information, and the Court has made clear in the Reynolds
09:52:09 19 case and in the Tomaselli case that they need LSW's specific
09:52:16 20 financials. They actually need to point to our conduct in
09:52:20 21 California. And that if they do not do that, as a matter of
09:52:22 22 law the punitives fail. So I just want to make sure I'm not
09:52:26 23 in a position where I'm being forced to put in financial
09:52:28 24 information in my case.

09:52:28 25 THE COURT: You're not.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:52:29 1 MR. BROSNAHAN: We won't make that argument, Your
09:52:31 2 Honor. I think the Court's instruction sets the appropriate
09:52:36 3 balance. And I will remind counsel and the Court that in
09:52:40 4 our opening statement, we predicated our punitive damages
09:52:44 5 request on the fees received by LSW and LSW alone on these
09:52:48 6 two policies. So I think that it is very much tied to LSW's
09:52:55 7 business in California.

09:52:57 8 MR. MARTENS: That's a separate question. They
09:52:58 9 certainly have to limit their request to conduct in
09:53:03 10 California, but the California case law makes clear they
09:53:06 11 must prove our financial condition. And it's not something
09:53:09 12 that we can even waive as the defendant because the case law
09:53:13 13 says that the state of California --

09:53:15 14 THE COURT: The case doesn't say that you can't
09:53:20 15 waive it.

09:53:20 16 MR. MARTENS: I think it says my conduct cannot
09:53:20 17 waive it, including my conduct at trial and my failure to
09:53:22 18 put in financials. So just the language I'm referring to in
09:53:22 19 Murakami --

09:53:30 20 THE COURT: Page?

09:53:30 21 MR. MARTENS: It's footnote seven on page 115 of
09:53:35 22 the decision.

09:53:36 23 THE COURT: Just a minute, please.

09:53:37 24 MR. MARTENS: Excuse me. Footnote five.

09:53:42 25 THE COURT: Yeah.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:53:43 1 MR. MARTENS: It says: Most important as we have
09:53:45 2 explained above, the primary interest that must be protected
09:53:49 3 is the public interest in punitive damages awards
09:53:52 4 inappropriate amounts. We cannot allow the public interest
09:53:55 5 to be thwarted by a defendant's oversight or tactics at
09:54:02 6 trial.

09:54:03 7 I believe the case law has interpreted that in
09:54:08 8 subsequent cases to say in effect that we cannot waive it.
09:54:15 9 So if I can --

09:54:17 10 THE COURT: Well, I have added an additional
09:54:19 11 sentence -- and I will print this out -- to the proposed
09:54:22 12 instruction. Plaintiffs have the burden to prove LSW's
09:54:26 13 financial condition. If you are unable to make a reasonable
09:54:30 14 estimate of LSW's financial activities in California, you
09:54:33 15 may not make an award of punitive damages.

09:54:38 16 MR. MARTENS: So just the Tomaselli case in
09:54:41 17 particular, Your Honor, it does use the waiver language.

09:54:44 18 THE COURT: Well, I accept it's their burden. Any
09:54:48 19 failure of proof on your part is irrelevant.

09:54:52 20 MR. MARTENS: I just wanted to make sure the Court
09:54:54 21 knew that I was not overstating when I said we can't waive
09:54:55 22 because it literally says a private litigant cannot by
09:54:58 23 inaction waive the requirement of financial data as a
09:55:01 24 prerequisite to any award.

09:55:04 25 They have to come forward with company-specific

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

09:55:07 1 information to get past Rule 50. I understand the Court's
09:55:11 2 instruction, and I will take a look at that and let the
09:55:15 3 Court know if we have any objection.

09:55:17 4 THE COURT: Okay.

09:55:18 5 Then we will be in recess.

09:55:19 6 (Recess taken at 9:55 a.m.;

10:00:43 7 proceeding resumed at 10:08 a.m.)

10:08:28 8 (Jury present)

10:08:28 9 THE COURT: Mr. Shapiro.

10:08:29 10 MR. SHAPIRO: Thank you, Your Honor.

10:08:29 11 BY MR. SHAPIRO:

10:08:30 12 Q Before we broke, Mr. Stemler, we were talking a little
10:08:35 13 bit about the potential to take loans in the policy? Yes,
10:08:37 14 sir?

10:08:38 15 A Yes.

10:08:39 16 Q What did you tell Ms. Walker about how you and she
10:08:45 17 would plan to figure out her loans in the future?

10:08:50 18 A When the time came, we would have to get together and
10:08:54 19 take a look at how much money was actually in the contract
10:08:57 20 at that point and make a determination how much could be
10:09:01 21 reasonably taken out.

10:09:03 22 Q Is that because, sir, that you didn't know what the S&P
10:09:06 23 would actually do between the point of sale and, say, the
10:09:11 24 next 15 years?

10:09:12 25 A No idea.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:09:14 1 Q Did you explain that clearly to Ms. Walker?

10:09:17 2 A Yes.

10:09:17 3 Q At some point Ms. Walker submitted an application to

10:09:26 4 LSW to buy a Provider policy?

10:09:32 5 A Correct.

10:09:33 6 Q Would you turn, sir, to Exhibit 784, which is already

10:09:35 7 in evidence.

10:09:36 8 A I'm there.

10:09:37 9 Q Is this Ms. Walker's life insurance policy?

10:09:40 10 A It's the application for it.

10:09:43 11 Q Is this Ms. Walker's application to purchase a life

10:09:46 12 insurance policy?

10:09:47 13 A Yes.

10:09:48 14 Q Did you assist Ms. Walker in her completion of the

10:09:51 15 application which is Exhibit 784-R?

10:09:55 16 A Yes.

10:09:56 17 Q Could you just tell the jury how the process goes of

10:09:59 18 taking a life insurance application.

10:10:04 19 A The top half was actually just the basic information,

10:10:07 20 was filled in by our staff just to make it go quicker. If

10:10:12 21 the decision at that meeting was to move forward, then I as

10:10:17 22 the agent need to fill out -- ask the questions and do those

10:10:21 23 things. And that's what we did.

10:10:23 24 Q Because there's any number of questions about

10:10:27 25 lifestyle, personal details, health, and so forth?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:10:31 1 A Yes.

10:10:32 2 Q Did you get those answers -- did you fill in the

10:10:35 3 answers to those questions with Ms. Walker in the room?

10:10:38 4 A She is the one who gave me the answers. Yes.

10:10:41 5 Q Right. So you asked her the questions and she gave you

10:10:43 6 the answers, and then you wrote it in per her instructions?

10:10:48 7 A Yes.

10:10:48 8 Q At the end of the process, does she sign the

10:10:50 9 application?

10:10:51 10 A Yes.

10:10:51 11 Q Does Ms. Walker have an opportunity to read and review

10:10:55 12 her application before she signs it?

10:10:58 13 A Sure.

10:10:58 14 Q You didn't hide any of the questions or answers before

10:11:01 15 she did?

10:11:02 16 A No.

10:11:02 17 Q Did you take a check from Ms. Walker at the time of the

10:11:05 18 application?

10:11:06 19 A Actually, no. I don't believe so, no.

10:11:10 20 Q So the application gets submitted and paying for it

10:11:13 21 comes later?

10:11:14 22 A Sometimes you do collect a check, but in this case we

10:11:18 23 wanted to get the underwriting done to make sure we knew

10:11:22 24 what the underwriting was.

10:11:24 25 Q Is that because when you do the illustration, have the

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10:11:24 1 discussions, you don't know what the medical underwriting is
10:11:28 2 going to be?
10:11:29 3 A Correct.
10:11:29 4 Q Did LSW accept or grant Ms. Walker's application for a
10:11:34 5 policy?
10:11:34 6 A Yes.
10:11:40 7 Q At some point did you deliver that policy to her?
10:11:43 8 A Yes.
10:11:45 9 Q If you would turn to Exhibit 676.
10:11:53 10 A 676?
10:11:56 11 Q Please, Mr. Stemler. What is 676?
10:12:03 12 A It's the policy receipt.
10:12:06 13 Q This is a policy receipt for the life insurance policy?
10:12:12 14 A Yes.
10:12:12 15 Q Did you deliver the policy to her?
10:12:14 16 A Yes.
10:12:15 17 Q Can you describe how that process goes.
10:12:17 18 A If I remember correctly, I actually went down to her
10:12:20 19 office. I had the policy. I had the other documents that
10:12:23 20 were there, and we -- I met her at the office, gave her the
10:12:28 21 policy. She signed the policy receipt, and I collected the
10:12:32 22 first premium check.
10:12:34 23 Q So you went to her office at a time that you and she
10:12:38 24 had selected that works for both of you?
10:12:42 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:12:42 1 Q You did this in person at her place of business?

10:12:45 2 A I believe that's correct.

10:12:46 3 Q And you brought the stack of material that's listed on

10:12:50 4 Exhibit 876?

10:12:52 5 A Yes.

10:12:52 6 Q And that includes, number one, the life insurance

10:12:55 7 policy itself?

10:12:56 8 A Correct.

10:12:56 9 Q A buyer's guide?

10:12:58 10 A Correct.

10:12:58 11 Q A second buyer's guide?

10:12:59 12 A Yes.

10:13:00 13 Q And also a proposal which matches the policy?

10:13:03 14 A Yes.

10:13:03 15 Q Is proposal which matches the policy another word for a

10:13:08 16 new illustration that matches the policy?

10:13:08 17 A Yes.

10:13:09 18 Q Did you deliver all of these documents to Ms. Walker?

10:13:13 19 A Yes.

10:13:13 20 Q Did you tell Ms. Walker to read her policy?

10:13:16 21 A Yes. And she had ten days to decide if she wanted to

10:13:23 22 take it or not.

10:13:25 23 Q So the ten days, is that sometimes referred to as a

10:13:26 24 free look period?

10:13:28 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:13:28 1 Q Under a free look period can Ms. Walker or any
10:13:32 2 policyholder just decide not to take the product?
10:13:35 3 A Yes.
10:13:35 4 Q Is that why you told her to read it?
10:13:38 5 A Yes.
10:13:39 6 Q And you're sure you were clear in that way with her?
10:13:42 7 A Yes.
10:13:43 8 Q Do you know why you deliver -- strike that. The life
10:13:46 9 insurance buyer's guide and the IUL buyer's guide, these are
10:13:51 10 documents you also provided?
10:13:52 11 A Yes.
10:13:52 12 Q You're familiar with those documents?
10:13:54 13 A Yes.
10:13:55 14 Q They all come in the same package that you delivered to
10:13:58 15 Ms. Walker?
10:13:59 16 A Yes.
10:14:02 17 Q If you would turn to the buyer's guide which is Exhibit
10:14:11 18 86. I believe you don't have a copy in your binder.
10:14:17 19 MR. SHAPIRO: So if I may, Your Honor?
10:14:19 20 THE COURT: You may.
10:14:21 21 MR. SHAPIRO: Thank you.
10:14:21 22 BY MR. SHAPIRO:
10:14:40 23 Q Mr. Stemler, is Exhibit 86 the SecurePlus Provider
10:14:45 24 buyer's guide that you gave to Ms. Walker?
10:14:47 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:14:53 1 Q Turn if you will to page 4 of the buyer's guide. Do
10:15:03 2 you see on the right-hand side it says basic strategy?
10:15:07 3 A Yes.
10:15:08 4 Q Moving down under where it says point to average
10:15:18 5 crediting strategy, are you with me?
10:15:21 6 A Yes.
10:15:24 7 Q Is this where in the buyer's guide it describes the
10:15:26 8 point to average crediting strategy of the Provider policy?
10:15:33 9 A Yes.
10:15:37 10 Q There and among any other number of other places?
10:15:40 11 A Yes.
10:15:41 12 Q Do you see the description where it says guarantees, no
10:15:43 13 cap, zero percent floor, and two percent interest annually
10:15:47 14 over five-year term?
10:15:49 15 A Yes.
10:15:49 16 Q Is that written description consistent with what you
10:15:54 17 explained to Ms. Walker when you went through her
10:15:56 18 illustration as you told us about before our break this
10:16:01 19 morning?
10:16:01 20 A Yes.
10:16:04 21 Q Turning the page, Mr. Stemler, do you see a diagram
10:16:16 22 that says option A level death benefit?
10:16:19 23 A Yes.
10:16:20 24 Q A little chart? Is that option A level death benefit
10:16:26 25 that is depicted in that diagram on page 5 of Exhibit 86

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10:16:31 1 another way to draw the same drawing that you did in the

10:16:35 2 room with her on the back of the illustration?

10:16:37 3 A Yes.

10:16:39 4 Q Is it the case that the white portion of that is the
10:16:43 5 net amount at risk that you described to her?

10:16:46 6 A Correct.

10:16:46 7 Q So what you described in the room on the back of her
10:16:49 8 illustration was just yet another explanation of what's also
10:16:54 9 here in her buyer's guide?

10:16:56 10 A Yes.

10:16:57 11 Q Is that information also in her policy, sir?

10:17:02 12 A That I don't --

10:17:04 13 Q You would have to pull up the document?

10:17:05 14 A I would have to pull up the document.

10:17:08 15 Q Fair enough. Then if you look on the right-hand
10:17:10 16 column, guaranteed interest rates.

10:17:12 17 A Yes.

10:17:16 18 Q Again, do you see the second paragraph, SecurePlus
10:17:20 19 Provider guaranteed minimum interest is two percent?

10:17:24 20 A Yes.

10:17:25 21 Q Is this yet another description of how the two percent
10:17:28 22 works on a five-year retroactive index basis?

10:17:32 23 A Yes.

10:17:32 24 Q In fact, it says 10.4 percent?

10:17:35 25 A That' two percent compounded over five years.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:17:39 1 Q If you wouldn't mind, sir, would you just read that
10:17:41 2 paragraph into the record.

10:17:43 3 A Sure. The SecurePlus Provider guaranteed minimum
10:17:46 4 interest is two percent annually for each five-year indexed
10:17:52 5 segment. At the end of each segment a test will compare the
10:17:56 6 actual indexed credits to the guaranteed interest rate of
10:17:59 7 two percent, 10.4 percent over a segment's five-year term.
10:18:06 8 If the indexed credits are less than the guaranteed rate,
10:18:10 9 the difference will be credited to the segment.

10:18:12 10 Q And that language again is in the buyer's guide that
10:18:17 11 you gave Ms. Walker with her policy?

10:18:19 12 A Yes.

10:18:20 13 Q At the time you told her about her ten-day free look
10:18:24 14 period?

10:18:24 15 A Yes.

10:18:28 16 Q Following the delivery of Ms. Walker's policy in
10:18:32 17 January 2008, did you have another meeting with her that
10:18:37 18 year?

10:18:37 19 A I believe we had one around April.

10:18:43 20 Q April or so of 2008? I know it's been forever ago.
10:18:48 21 Around April 2008?

10:18:49 22 A I think.

10:18:50 23 Q Did the purpose of that meeting have to do with her LSW
10:18:53 24 policy?

10:18:54 25 A I don't believe so.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:18:55 1 Q What was -- just briefly, what was the purpose of that
10:18:57 2 meeting in April 2008?

10:19:00 3 A Without looking at our notes from the file, I think
10:19:03 4 that was the one -- that was the first discussion we had
10:19:07 5 regarding the annuity for the pension plan. I don't have
10:19:14 6 the notes here.

10:19:16 7 Q Would it refresh your memory to look at the log of your
10:19:21 8 meetings from your office file?

10:19:23 9 A Yes.

10:19:24 10 Q If you would open your binder, Mr. Stemler, to what's
10:19:30 11 in your binder as 867-D. Just tell me when you are there.

10:19:46 12 A I'm there.

10:19:48 13 Q Are the pages behind tab 867-D from a log that's
10:19:55 14 maintained at the office of all the contacts with a client
10:20:00 15 like Ms. Walker?

10:20:01 16 A Yes.

10:20:03 17 MR. SHAPIRO: Your Honor, we would move into
10:20:03 18 evidence Exhibit 867-D, which is pages 281 through 286.

10:20:16 19 MR. FOSTER: Objection, Your Honor. This is
10:20:16 20 hearsay upon hearsay.

10:20:20 21 MR. SHAPIRO: I can lay the foundation.

10:20:22 22 THE COURT: Lay the foundation.

10:20:22 23 BY MR. SHAPIRO:

10:20:23 24 Q Number one, Mr. Stemler, do you recognize
10:20:27 25 Exhibit 867-D?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:20:29 1 A Yes.

10:20:30 2 Q What is 867-D?

10:20:33 3 A It's the log that we keep of all contact with clients,

10:20:39 4 both personal and verbal.

10:20:41 5 Q When you say we, you're talking about at the insurance

10:20:46 6 office?

10:20:47 7 A At Preservation Financial. Marta Wood is charged with

10:20:51 8 maintaining this log.

10:20:52 9 Q Is this a business record of Preservation Financial.

10:20:56 10 A Yes.

10:20:56 11 Q Is Exhibit 867-D made and kept in the usual course of

10:21:01 12 the Preservation Financial business?

10:21:02 13 A Yes.

10:21:03 14 Q Does Marta Wood have knowledge of the information she

10:21:06 15 records on the log?

10:21:07 16 A Yes.

10:21:08 17 MR. SHAPIRO: Your Honor, we would move

10:21:08 18 Exhibit 867-D into evidence.

10:21:13 19 MR. FOSTER: I don't think this is a business

10:21:15 20 record, Your Honor.

10:21:17 21 THE COURT: 867-D will be received.

10:21:18 22 MR. SHAPIRO: Thank you, Your Honor.

10:21:18 23 (Exhibit No. 867-D received in evidence)

10:21:18 24 BY MR. SHAPIRO:

10:21:19 25 Q So going back to the chronology, do you see on 867,

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:21:30 1 page 281, there are references to meetings in the spring of
10:21:43 2 2008?

10:21:45 3 A Yes.

10:21:49 4 Q Does that help refresh your memory that you met with
10:21:53 5 her at least at some point during that spring?

10:21:55 6 A Yes.

10:21:56 7 Q To your best memory just briefly what you talked about
10:22:00 8 that didn't have to do with the LSW policy.

10:22:05 9 A This appears at the point I think when we started
10:22:08 10 having the discussions of what to do with the additional
10:22:13 11 funds regarding retirement and things of that nature. If I
10:22:17 12 am reading this correctly, we knew some money was going to
10:22:29 13 be coming available, but we also knew she was planning to
10:22:32 14 get married. And so we basically said, you know, let's wait
10:22:36 15 until after you get married and things of that nature.

10:22:40 16 Q Are you referring maybe to an entry that could have
10:22:41 17 been July 2008?

10:22:43 18 A Yes.

10:22:44 19 Q I guess that's why we have logs. Yes, sir?

10:22:46 20 A Yes.

10:22:49 21 Q And your memory is she came back to the office to talk
10:22:52 22 to you about some more financial planning?

10:22:54 23 A Yes.

10:22:58 24 Q As we see right here in the exhibit, she also let Jeff
10:23:02 25 and Mike know that she's getting married in July? Is that

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:23:06 1 what you're referring to?

10:23:07 2 A Yes.

10:23:07 3 Q She said in some form of words: Go get married and
10:23:09 4 when things settle out, we will visit?

10:23:12 5 A Correct.

10:23:13 6 Q Does LSW send annual statements to policyholders?

10:23:17 7 A Yes.

10:23:19 8 Q Did LSW send Ms. Walker an annual statement after her
10:23:25 9 first year with the Provider policy?

10:23:27 10 A Yes.

10:23:28 11 Q Could you turn now to 867 -- could you turn, sir, to
10:23:35 12 Exhibit 94, which has already been admitted into evidence.
10:23:39 13 Before turning to the exhibit, how did the stock market do
10:23:53 14 in 2008?

10:23:54 15 A It went down about 30-plus percent.

10:23:58 16 Q What kind of impact did a decline of 30-plus percent in
10:24:02 17 2008 have on the Provider policy that you had sold to
10:24:06 18 Ms. Walker?

10:24:07 19 A It was credited with zero.

10:24:10 20 Q Why was it credited with zero when the market was down
10:24:13 21 30-plus percent?

10:24:15 22 A Because that's how indexing works. You can get some of
10:24:18 23 the upside, but you can't go below zero.

10:24:22 24 Q So in that first year she got very much the benefit of
10:24:27 25 the zero percent floor?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:24:29 1 A Yes.

10:24:29 2 Q Did you discuss the annual statement that is Exhibit 94

10:24:33 3 with Ms. Walker?

10:24:35 4 A Yes.

10:24:37 5 Q Do you remember discussing with her how the market did

10:24:40 6 in 2008?

10:24:44 7 A It was ugly.

10:24:49 8 Q So the best you can, just tell the jury what you said

10:24:51 9 to her and what she said to you around the time she got the

10:24:56 10 annual statement.

10:24:57 11 A I don't remember the conversation, per se. The fact

10:25:00 12 was -- the good news was she didn't lose 34 percent on that

10:25:06 13 amount of money.

10:25:06 14 Q You conveyed that in some form of words to her?

10:25:09 15 A Yes.

10:25:10 16 Q At the time she discussed the performance of her

10:25:11 17 insurance policy after her first year, did she complain to

10:25:15 18 you?

10:25:15 19 A No. She was asking just how did it work; did I get

10:25:18 20 credited anything. And we said no, not from the index.

10:25:25 21 There was a small crediting --

10:25:27 22 Q \$435?

10:25:29 23 A Because that was when the money sat in that basic

10:25:33 24 account until they put it into the index.

10:25:35 25 Q So she got a few hundred dollars. She did a little bit

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:25:37 1 better than zero?

10:25:39 2 A A little bit better.

10:25:40 3 Q And after a year and the market did a little bit worse

10:25:41 4 than 30 percent down?

10:25:46 5 A Yes.

10:25:47 6 Q Did you explain that to her?

10:25:48 7 A Yes.

10:25:48 8 Q Did Mr. Walker say in any form of words to you:

10:25:52 9 Mr. Stemler, you promised me two percent?

10:25:54 10 A No.

10:25:55 11 Q Did she say in any form of words to you: This is not

10:25:59 12 the product that I thought I was buying?

10:26:01 13 A No.

10:26:01 14 Q Did she express in any way, shape, or form any

10:26:03 15 dissatisfaction with the LSW policy?

10:26:06 16 A No.

10:26:07 17 Q How about with the customer service you were providing?

10:26:10 18 A She didn't mention anything at that point.

10:26:12 19 Q So just looking at the annual statement that was sent,

10:26:17 20 it says beginning accumulated value of zero?

10:26:21 21 A Correct.

10:26:21 22 Q That's because this was the first year, right, so she

10:26:24 23 started with zero?

10:26:27 24 A Yes.

10:26:27 25 Q Then \$112,000, that was the premium payment; right?

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10:26:30 1 A Yes.

10:26:30 2 Q Withdrawals, zero?

10:26:33 3 A Right.

10:26:33 4 Q Monthly deductions?

10:26:33 5 A Correct.

10:26:33 6 Q Is that the cumulative, you know, costs, charges, and

10:26:33 7 so forth that are taken out of the policy?

10:26:38 8 A Correct.

10:26:39 9 Q Did Ms. Walker complain in any way, shape, or form

10:26:43 10 about the fact that there was 20,000 or 19,606.58 taken out

10:26:51 11 of the policy?

10:26:52 12 A No. When the original illustration shows that number,

10:26:54 13 so that would have already been factored in.

10:26:58 14 Q It should have been of no surprise to her; right?

10:27:01 15 A Correct.

10:27:01 16 Q And she certainly didn't suggest that she was

10:27:03 17 dissatisfied or surprised by that either?

10:27:05 18 A No, not that I know of.

10:27:06 19 Q And then below it says the \$435.11?

10:27:12 20 A Correct.

10:27:13 21 Q And that's what she got?

10:27:15 22 A Correct.

10:27:15 23 Q Now, if you just turn two pages in the annual

10:27:20 24 statement. Is this the breakout or itemization of the

10:27:28 25 premiums received?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:27:29 1 A Yes.

10:27:31 2 Q Is there also an itemization of the expense charges?

10:27:35 3 A Yes.

10:27:35 4 Q And they are listed, what, to the penny, sir, for every
10:27:38 5 month?

10:27:39 6 A That's correct.

10:27:39 7 Q And then those expense charges amount to how much?

10:27:45 8 A I believe it's the 19,000 on the other page.

10:27:49 9 Q Right. And there's actually two columns; right?
10:27:50 10 There's one for expense charges and there is one for cost of
10:27:56 11 insurance?

10:27:57 12 A Correct.

10:28:00 13 Q How much were the total expense charges?

10:28:05 14 A \$18,526.04.

10:28:10 15 Q And then there's also a separate column for cost of
10:28:13 16 insurance?

10:28:13 17 A Yes.

10:28:14 18 Q And that adds up to the 19,000 plus that's on the front
10:28:19 19 page?

10:28:19 20 A It should.

10:28:20 21 Q So it shows it actually twice in the annual statement?

10:28:26 22 A Yes.

10:28:26 23 Q She didn't complain about any of these expenses either?

10:28:30 24 A That I remember, no.

10:28:35 25 Q If you would, Mr. Stemler, now turn to Exhibit 867-A,

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:28:43 1 which has previously been admitted into evidence. In
10:28:54 2 addition to the conversation you had with Ms. Walker and in
10:28:58 3 addition to the annual statement about the zero or the \$435
10:29:05 4 she received, did your office also send her a letter telling
10:29:08 5 her what the interest that had been credited to her policy
10:29:11 6 was?

10:29:13 7 A I believe that's what this letter is.

10:29:16 8 Q Is this letter from Marta Wood?

10:29:19 9 A Yes.

10:29:28 10 Q Marta Wood is the woman you referred to earlier who is
10:29:31 11 part of your team?

10:29:32 12 A Yes.

10:29:33 13 Q Could you read for the jury what Ms. Wood wrote in her
10:29:39 14 letter on your behalf to Ms. Walker, the second paragraph.

10:29:43 15 A Jeff also asked that I obtain the amount of interest
10:29:48 16 earned on your policy during 2008. The interest earned is
10:29:52 17 credited to your policy each year on the 21st of January,
10:29:56 18 and for 2008 it was zero. To obtain the amount of interest
10:30:00 19 credited for your policy each year, you can call LSW
10:30:06 20 customer service, 800-732-8939, after January 21. You will
10:30:14 21 need to reference your LSW policy number, LS 0156670. If I
10:30:22 22 can be of further assistance or if you have any other
10:30:24 23 questions, please call us at 800-303-8754, extension 5415.

10:30:33 24 Q So is it the case, according to this letter, that the
10:30:33 25 interest crediting is done on the 21st of January?

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10:30:37 1 A That's the end of the 30 days, if you will. So by then
10:30:42 2 it has been credited.

10:30:44 3 Q That's how the system works?

10:30:45 4 A Yes.

10:30:46 5 Q And then here six days later your office is actually
10:30:49 6 sending her a letter saying it was zero?

10:30:52 7 A Confirming it, yes.

10:30:53 8 Q After this letter went out, did you ever hear back from
10:30:56 9 Ms. Walker saying no, no, I was due two percent?

10:30:59 10 A No.

10:30:59 11 Q And no other memory of any complaints whatsoever?

10:31:02 12 A No. Actually I remember -- I think we have -- she said
10:31:06 13 the second premium.

10:31:09 14 Q So after the conversation you had with her about how
10:31:13 15 the policy did with the zero, after the annual statement,
10:31:14 16 and then after this additional letter, the next thing that
10:31:14 17 happened is she paid another premium?

10:31:29 18 A I believe so.

10:31:29 19 Q Was that another \$112,000?

10:31:31 20 A Again, I believe so.

10:31:32 21 Q After Ms. Walker paid her second premium of \$112,000 in
10:31:37 22 February 2009, did you see her again that year?

10:31:41 23 A That's when I would again need to go back to the log.

10:31:47 24 Q Sure.

10:31:49 25 A That's 867; right?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:31:52 1 Q 867-D. I believe there is a reference to a meeting on
10:32:07 2 April 15th.

10:32:12 3 A Jeff met with her -- Jeff met with Joyce today at her
10:32:19 4 office. He has scheduled an appointment to meet with her
10:32:23 5 again with Mike next week, April 22nd, at her office.

10:32:28 6 Q Is this a memory of meeting with her in the spring?

10:32:32 7 A Yes.

10:32:32 8 Q At that meeting did she complain in any way, shape, or
10:32:37 9 form about her LSW policy?

10:32:40 10 A No.

10:32:42 11 Q At that meeting did she complain in any way, shape, or
10:32:43 12 form about the customer service that you and Marta and Mike
10:32:45 13 were providing to her?

10:32:48 14 A No.

10:32:49 15 Q Is it the case, sir, that she then filed a complaint
10:32:53 16 with LSW about the policy and your conduct in selling it?

10:32:59 17 A Yes.

10:33:00 18 Q Was that in June of 2009?

10:33:12 19 A I believe it is, but I just can't find it.

10:33:15 20 Q Sure. Putting aside the precise date, in that
10:33:18 21 complaint did Ms. Walker make some very serious allegations
10:33:22 22 about you, sir?

10:33:23 23 A Yes.

10:33:23 24 Q Now, that was sort of five years ago in which she first
10:33:29 25 questioned your integrity?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:33:30 1 A Yes.

10:33:31 2 Q One more time, did you do anything wrong to or with

10:33:34 3 Ms. Walker?

10:33:35 4 A No.

10:33:36 5 Q Did you lie to her?

10:33:37 6 A No.

10:33:37 7 Q Did you hide anything from her?

10:33:39 8 A No.

10:33:40 9 Q Did you always treat her with integrity?

10:33:43 10 A Yes.

10:33:44 11 MR. SHAPIRO: Thank you, sir.

10:34:13 12 THE COURT: Mr. Foster.

10:34:16 13 MR. FOSTER: Thank you, Your Honor.

10:34:18 14 May I approach the witness with a binder, Your

10:35:27 15 Honor?

10:35:29 16 THE COURT: You may.

10:35:29 17 CROSS-EXAMINATION

10:35:30 18 BY MR. FOSTER:

10:35:43 19 Q Good morning, Mr. Stemler.

10:35:45 20 A Good morning.

10:35:46 21 Q We have met before; correct?

10:35:48 22 A Yes.

10:35:49 23 Q I took your testimony at a deposition here in Irvine;

10:35:51 24 correct?

10:35:53 25 A That's correct.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:35:55 1 Q And you are an executive vice-president of sales at
10:35:58 2 Asset Marketing Systems; correct?

10:36:01 3 A Yes.

10:36:01 4 Q And Asset Marketing Systems has approximately 600
10:36:09 5 agents nationwide who place life insurance policies;
10:36:13 6 correct?

10:36:14 7 A Correct.

10:36:15 8 Q In talking about this specific insurance policy, the
10:36:20 9 LSW Provider policy, LSW did not ever provide you with any
10:36:24 10 information related to the chance that Ms. Walker's policy
10:36:27 11 would lapse before her life expectancy; did it?

10:36:32 12 A Other than the standard information that if they don't
10:36:37 13 pay premiums, it will lapse.

10:36:39 14 Q So other than if you don't pay premiums, it will lapse,
10:36:43 15 LSW did not provide you any information related to the
10:36:46 16 probability that Ms. Walker's policy would lapse before her
10:36:50 17 life expectancy?

10:36:51 18 A I believe that's correct.

10:36:53 19 Q And since LSW never provided you with any information
10:36:57 20 like that at all, you never provided it to Ms. Walker; did
10:37:00 21 you?

10:37:01 22 A No.

10:37:05 23 Q And have you ever been provided with any numbers or
10:37:10 24 heard any numbers outside the context of this litigation
10:37:14 25 related to the probability that the Provider policy would

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:37:17 1 lapse before the end of an insured person's life expectancy?

10:37:22 2 A No.

10:37:24 3 Q LSW never provided you with any such numbers?

10:37:28 4 A The likelihood of it lapsing?

10:37:32 5 Q Before an insured person's life expectancy.

10:37:37 6 A Not that I know of.

10:37:39 7 Q And you did not provide them to Ms. Walker?

10:37:42 8 A Correct.

10:37:42 9 Q So I'm going to show you slide 205-01. This is a
10:37:57 10 calculation of the lapse probability for all policies in a
10:38:02 11 sample with loans and withdrawals as illustrated in the
10:38:05 12 illustration, and the calculation is that for SecurePlus
10:38:10 13 Provider 59.8 percent chance of lapse at or before life
10:38:15 14 expectancy; do you see that?

10:38:17 15 A Yes.

10:38:17 16 Q And LSW never provided you with any numbers like this
10:38:21 17 at all; did they?

10:38:22 18 A No.

10:38:23 19 Q And since you were not aware of any such numbers, you
10:38:27 20 did not provide them to Ms. Walker; did you?

10:38:30 21 A No.

10:38:31 22 Q So when you discussed the potential to use the Provider
10:38:34 23 policy to take loans or withdrawals, these types of lapse
10:38:40 24 probability statistics were not in way part of the
10:38:43 25 conversation you had with Ms. Walker; were they?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:38:46 1 A No.

10:38:46 2 Q Now, did LSW ever tell you a percentage of Provider
10:38:52 3 policies that it expected to lapse?

10:38:56 4 A No.

10:38:56 5 Q And since LSW never provided you with that information,
10:38:58 6 of course you couldn't provide it to Ms. Walker; correct?

10:39:02 7 A Correct.

10:39:03 8 Q And since LSW didn't provide you with that information,
10:39:07 9 none of the agents that worked for Asset Marketing Systems
10:39:10 10 could provide it to Ms. Walker; correct?

10:39:13 11 A Correct.

10:39:17 12 MR. SHAPIRO: Objection, Your Honor, as to other
10:39:17 13 agents.

10:39:19 14 MR. FOSTER: He runs a marketing organization of
10:39:22 15 600 agents, Your Honor.

10:39:24 16 THE COURT: Overruled.

10:39:24 17 BY MR. FOSTER:

10:39:25 18 Q And you are aware of course that the Provider
10:39:27 19 illustrations, they project non-guaranteed values using an
10:39:31 20 essentially constant rate of return without any year-to-year
10:39:36 21 variability; correct?

10:39:37 22 A Correct.

10:39:44 23 Q But is there a risk that the Provider policy might
10:39:48 24 lapse if the S&P 500 performed just as well in the future as
10:39:51 25 it did in the past on average?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:39:56 1 A I know of nothing that would support that.

10:39:58 2 Q You have no idea about that whatsoever?

10:40:02 3 A That it would lapse, no.

10:40:03 4 Q So if individuals at LSW were aware that the sequence
10:40:17 5 of returns would have an impact on the values depicted in
10:40:23 6 the illustration, that was never anything that they shared
10:40:26 7 with you; correct?

10:40:27 8 MR. SHAPIRO: Objection, Your Honor. We're not
10:40:28 9 sure there is a basis for that question.

10:40:31 10 MR. FOSTER: It's Ms. MacGowan's testimony.

10:40:35 11 THE COURT: Overruled.

10:40:36 12 THE WITNESS: Can you say that again.

10:40:39 13 BY MR. FOSTER:

10:40:39 14 Q Yes. If it was known to individuals at LSW that the
10:40:46 15 sequence of returns would have an effect on the likelihood
10:40:48 16 that the Provider policy would lapse even if S&P 500
10:40:51 17 performed on average in the future as it did in the past,
10:40:54 18 that was information that was not shared with you; correct?

10:40:59 19 A No.

10:40:59 20 Q And was not shared as far as you know with any of the
10:41:03 21 agents that work under you?

10:41:06 22 A No.

10:41:06 23 Q As far as you know, it was not shared with any agents
10:41:10 24 across this country?

10:41:12 25 A Correct.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:41:14 1 Q And since it was never shared with you, you never
10:41:17 2 discussed such matters with Ms. Walker; correct?

10:41:21 3 A Correct.

10:41:25 4 Q And you never told her about the possibility that the
10:41:29 5 Provider policy might lapse even if the S&P 500 performed
10:41:33 6 just as well on average in the future as it did in the past;
10:41:36 7 correct?

10:41:38 8 A I have no reason to believe that, so, no.

10:41:40 9 Q You have no reason to believe that sitting here today?

10:41:43 10 A Correct.

10:41:44 11 Q And LSW has never transmitted to you any information
10:41:47 12 about that possibility; correct?

10:41:49 13 A Correct.

10:41:49 14 Q They have never transmitted that information to any of
10:41:54 15 the individuals in your agent force; correct?

10:41:56 16 A Correct.

10:41:57 17 Q Now, you are familiar with the concept of Monte Carlo
10:42:00 18 simulations; correct?

10:42:01 19 A Yes.

10:42:01 20 Q Now, Monte Carlo simulations are not part of the basic
10:42:07 21 LSW Provider illustration; are they?

10:42:10 22 A Not that I know of.

10:42:11 23 Q Okay. And as far as you know, there is no supplemental
10:42:15 24 illustration or optional report that includes any sort of
10:42:19 25 Monte Carlo analysis; correct?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:42:21 1 A Correct.

10:42:22 2 Q If I can put up slide 102-01. It's a Monte Carlo
10:42:31 3 analysis conducted for Ms. Walker's policy. It's based on
10:42:37 4 her illustration, the illustration you discussed earlier
10:42:39 5 today. It shows that even if all of her premiums are paid
10:42:47 6 just as depicted in the illustration, she would have a
10:42:51 7 61 percent chance of lapse before her life expectancy of 84
10:42:56 8 years even if the S&P 500 performed on average in the future
10:43:00 9 as it has in the past just because of market volatility. Do
10:43:06 10 you understand that?

10:43:07 11 A I understand what you said.

10:43:08 12 Q And this information in form or substance was never
10:43:16 13 provided to you by LSW; correct?

10:43:18 14 A Correct.

10:43:19 15 Q And since LSW never provided you with it, you never
10:43:22 16 provided it to Ms. Walker?

10:43:24 17 A Correct.

10:43:25 18 Q So these types of risks were not part of the discussion
10:43:28 19 at all that you had with Ms. Walker about taking loans or
10:43:32 20 withdrawals; correct?

10:43:33 21 A Correct.

10:43:33 22 Q And if LSW required use of lapse risk statistics,
10:43:39 23 stochastic scenarios, or Monte Carlo simulations with its
10:43:44 24 Provider illustrations, would you have used those
10:43:47 25 simulations?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

10:43:50 1 MR. SHAPIRO: Objection, Your Honor. Compound.

10:43:52 2 THE COURT: Overruled.

10:43:53 3 THE WITNESS: If they required it, I would have
10:43:57 4 presented it.

10:43:57 5 BY MR. FOSTER:

10:43:57 6 Q So if they had required Monte Carlo simulations, you
10:44:01 7 would have presented it?

10:44:02 8 A Yes.

10:44:02 9 Q And if they had required stochastic analysis, you would
10:44:06 10 have presented it?

10:44:07 11 A If they required it, yes.

10:44:09 12 Q And if they just required disclosure that the policy
10:44:13 13 had a risk of lapse or reduced value even if the S&P 500
10:44:17 14 returned on average the amount depicted in the current basis
10:44:21 15 B values in the illustration, you would have made that
10:44:24 16 disclosure?

10:44:25 17 A If that was required, yes.

10:44:28 18 Q And you would have provided all those disclosures with
10:44:32 19 Ms. Walker if LSW had required it; correct?

10:44:35 20 A Yes.

10:44:36 21 Q As far as you know, does LSW quantify the effect on
10:44:43 22 policy values that results from returns not being constant
10:44:47 23 in the real world?

10:44:51 24 A As far as I know, no.

10:44:55 25 Q Putting up Exhibit 565-58, reduced value to volatility

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10:45:05 1 defect. And this is a sample of all policyholders with
10:45:05 2 Providers who had sales illustrations, and it looked at the
10:45:05 3 value depicted in the current basis B columns of their
10:45:05 4 illustrations and compared it to how the policies would
10:45:20 5 actually function with market volatility even if the S&P 500
10:45:23 6 returned on average the same in the future as it did in the
10:45:28 7 past and found that Provider policies had a 95 percent
10:45:33 8 likelihood of having reduced value as compared to the
10:45:38 9 current basis B values in the illustration.

10:45:40 10 The question for you is that LSW never provided
10:45:43 11 you with any information of this sort or substance; correct?

10:45:47 12 A As far as I know, correct.

10:45:50 13 Q And LSW never provided you with any information related
10:45:53 14 to the possibility that the policies would suffer reduced
10:45:57 15 value even if the S&P 500 returned on average the rate
10:46:03 16 depicted in the current basis B values of the illustration?

10:46:06 17 A Repeat that question.

10:46:09 18 Q Yeah. LSW never provided you with any information of
10:46:13 19 this sort regarding reduced policy value as compared to the
10:46:19 20 current basis B values depicted in the illustration that
10:46:22 21 could result if the S&P 500 performed on average in the
10:46:27 22 future as the rate used to calculate the current basis B
10:46:33 23 values shown in the illustration?

10:46:34 24 A They didn't quantify it with a percentage.

10:46:37 25 Q Thank you. Since they didn't quantify it in any way,

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10:46:43 1 that was not a part of your discussion of the Provider
10:46:46 2 policy with Ms. Walker or anything like this type of
10:46:47 3 quantification?

10:46:51 4 A The conversation that I had with her is that the real
10:46:53 5 world is not seven percent constant. It was going to be up
10:46:58 6 and down. That's why we had to get together eventually to
10:47:03 7 determine where did it end up.

10:47:05 8 Q Exactly. So in the real world, you know, we know that
10:47:08 9 the S&P 500, according to the historical back testing you
10:47:13 10 talked about, was 7.5 percent; correct? And if we add a lot
10:47:16 11 of years in the future that unfortunately were like 2008,
10:47:19 12 the market could return lower than 7.5 percent; correct?

10:47:24 13 A Correct.

10:47:24 14 Q Or if we add a lot years that hopefully were like last
10:47:29 15 year, the market could return on average higher than
10:47:31 16 7.5 percent; correct?

10:47:33 17 A Correct.

10:47:33 18 Q And that's true of the seven percent that you used to
10:47:38 19 make it a little more conservative; correct? The market
10:47:41 20 could be higher on average in the future or lower on average
10:47:43 21 in the future; correct?

10:47:46 22 A Correct.

10:47:46 23 Q But your testimony is that you have no idea about the
10:47:49 24 risk to the Provider policy even if the S&P 500 performed
10:47:55 25 just as well in the future as it did on average in the past;

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10:47:57 1 correct?

10:47:59 2 A Correct.

10:47:59 3 Q So that was the type of risk that was not discussed
10:48:02 4 with Ms. Walker; correct?

10:48:03 5 A Correct.

10:48:08 6 Q If I told you that that risk would produce a reduced
10:48:13 7 expected value of -- well, let me ask you something else.
10:48:20 8 When Ms. Walker later filed her complaint and complained
10:48:23 9 about the policy and the projections of the values, you said
10:48:26 10 that the values that you were depicting were supported by
10:48:29 11 the historical back testing that LSW had conducted;
10:48:32 12 correction?

10:48:34 13 A Yes.

10:48:35 14 Q So you relied on the historical back testing and the
10:48:40 15 calculations that LSW engaged in to present the illustration
10:48:44 16 in the policy to Ms. Walker; correct?

10:48:46 17 A Correct.

10:48:51 18 Q And you testified before that you wouldn't sell a
10:48:54 19 policy or you wouldn't be comfortable selling a policy if
10:48:58 20 you weren't sure that you understood the policy; correct?

10:49:01 21 A Correct.

10:49:02 22 Q So if this information is true and you testified that
10:49:06 23 you didn't understand these types of lapse probabilities
10:49:10 24 because they weren't provided to you, you would not sell the
10:49:15 25 Provider policy unless you could come to understand this;

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10:49:18 1 correct?

10:49:19 2 A I have no belief that these are credible.

10:49:23 3 Q Well, assuming these are credible and there is a
10:49:28 4 95 percent chance of reduced value and LSW required you to
10:49:34 5 provide that information whether numerically or in narrative
10:49:39 6 form, you would provide that disclosure to policyholders;
10:49:43 7 correct?

10:49:43 8 A It depends.

10:49:45 9 Q If they required it?

10:49:46 10 A If they required it, yes.

10:49:48 11 Q You would follow LSW's guidelines for marketing and
10:49:52 12 selling these policies; correct?

10:49:53 13 A Of course.

10:49:56 14 Q Now, I want to talk to you about what you refer to as
10:50:03 15 the multi-step process. Do you remember that testimony?

10:50:08 16 A Yes.

10:50:10 17 Q And that's a CFP approach; is that correct?

10:50:14 18 A Correct.

10:50:16 19 Q You testified that you followed the CFP approach with
10:50:20 20 Ms. Walker; correct?

10:50:22 21 A Yes.

10:50:23 22 Q The CFP approach you said involves three to five
10:50:27 23 meetings; correct?

10:50:29 24 A Yes.

10:50:29 25 Q And it involves phone calls; correct?

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10:50:32 1 A If they are necessary, sure.

10:50:33 2 Q But isn't it true that prior to her purchase of the
10:50:37 3 policy, you were only involved in this initial dinner and
10:50:42 4 then one meeting on November 14 when she came in and filled
10:50:46 5 out the application; isn't that correct?

10:50:49 6 A Yes.

10:50:49 7 Q So those are two meetings; correct?

10:50:51 8 A Correct.

10:50:52 9 Q Mr. Botkin conducted the other meetings; correct?

10:50:54 10 A Correct.

10:50:56 11 Q And you had no phone calls with Ms. Walker ever, did
10:50:59 12 you, before the sale of the policy to her?

10:51:04 13 A No.

10:51:04 14 Q No e-mails with her at all before the sale of the
10:51:06 15 policy?

10:51:06 16 A Not that I remember.

10:51:07 17 Q And the first meeting we're talking about, that was a
10:51:11 18 dinner; correct?

10:51:12 19 A Yes.

10:51:12 20 Q And there were a lot of people at the dinner; correct?

10:51:14 21 A Correct.

10:51:15 22 Q And you don't specifically recall talking to Ms. Walker
10:51:19 23 at that dinner; do you?

10:51:21 24 A No.

10:51:21 25 Q Okay. So taking that dinner out of the equation, there

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10:51:24 1 is only one meeting that you ever had with Ms. Walker prior
10:51:27 2 to the sale of the policy; correct?

10:51:30 3 A Correct.

10:51:30 4 Q And as we discussed before, at the dinner you didn't
10:51:35 5 even discuss the Provider policy or LSW product; correct?

10:51:38 6 A Correct.

10:51:38 7 Q It was just about general retirement concepts; correct?

10:51:43 8 A Yes.

10:51:43 9 Q And we looked before at a response sheet that she
10:51:49 10 filled out at that dinner. It was Exhibit 867. I will put
10:51:59 11 up page 867-04. It's a bunch of financial planning
10:52:06 12 objectives, and I have highlighted one. Do you see that,
10:52:12 13 safety of retirement money?

10:52:13 14 A Yes.

10:52:14 15 Q So she marked a nine; correct?

10:52:16 16 A Correct.

10:52:17 17 Q And that indicates that the safety of her retirement
10:52:20 18 money was extremely important to her; correct?

10:52:23 19 A Correct.

10:52:24 20 Q Now, going to the next page, which is 867-65, it says:
10:52:41 21 What is the main concern for your money? Her main concern
10:52:46 22 was enough for retirement, be able to retire early; is that
10:52:51 23 correct?

10:52:52 24 A Yes.

10:53:02 25 Q But you did not discuss this particular sheet with

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10:53:04 1 Ms. Walker; correct?

10:53:07 2 A I do not discuss that sheet with Ms. Walker.

10:53:10 3 Q Because when Ms. Walker came in for meetings with
10:53:15 4 Preservation Financial, she dealt with Mr. Botkin initially;
10:53:21 5 correct?

10:53:22 6 A That's correct.

10:53:23 7 Q And you didn't attend the first scheduled meeting which
10:53:27 8 was on August 20, 2007; did you?

10:53:30 9 A No.

10:53:30 10 Q Mr. Botkin and Ms. Walker were the only attendees at
10:53:34 11 that meeting?

10:53:36 12 A Correct.

10:53:38 13 Q And you didn't attend the second scheduled meeting
10:53:41 14 which was on September 19, 2007; did you?

10:53:45 15 A Correct.

10:53:45 16 Q And Mr. Botkin and Ms. Walker were the only attendees
10:53:50 17 at that meeting; correct?

10:53:51 18 A Correct.

10:53:51 19 Q And you didn't attend the third scheduled meeting which
10:53:51 20 occurred on October 16th, 2007, either; did you?

10:53:58 21 A Correct.

10:53:59 22 Q Mr. Botkin and Ms. Walker were the only attendees at
10:54:04 23 the meeting; correct?

10:54:06 24 A I believe so.

10:54:06 25 Q And you testified previously, I believe, that this was

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10:54:07 1 the first meeting where the Provider illustration was gone
10:54:11 2 over with Ms. Walker; correct?

10:54:13 3 A Correct.

10:54:13 4 Q So we have seen illustrations that predate
10:54:16 5 October 16th, and in that meeting your understanding is that
10:54:19 6 Mr. Botkin went over the Provider illustration with her;
10:54:22 7 correct?

10:54:22 8 A Yes.

10:54:22 9 Q And the fourth meeting occurred on November 14, 2007;
10:54:26 10 correct?

10:54:28 11 A I believe that's correct.

10:54:29 12 Q And so -- and you were present at that meeting?

10:54:40 13 A Yes.

10:54:43 14 Q I believe you testified with Mr. Shapiro that you
10:54:49 15 remembered that the meeting was at least an hour, possibly
10:54:54 16 an hour and a half; is that right?

10:54:57 17 A I believe so.

10:54:58 18 Q And you were asked a question about that topic at your
10:55:01 19 deposition; weren't you?

10:55:04 20 A I may have been.

10:55:05 21 Q And you were asked a question at your deposition --
10:55:10 22 well, let's take a look at the transcript. Do you have the
10:55:12 23 transcript up there?

10:55:14 24 A Yes.

10:55:22 25 Q If we go to page 40 of the transcript and look at lines

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10:55:31 1 9 to 11. If you would read those to yourself.

10:55:39 2 A (Witness reading document) Do you remember how long
10:55:40 3 the November 14th meeting was? The answer is no.

10:55:44 4 Q So that was your answer that you gave at your
10:55:46 5 deposition, correct, that you did not remember how long that
10:55:49 6 meeting was?

10:55:52 7 A Exactly. Correct.

10:55:54 8 Q And your testimony today here is directly inconsistent
10:55:58 9 with that; correct?

10:55:58 10 A No.

10:55:59 11 Q You said you remembered that it was an hour and a half?

10:56:04 12 A An hour to an hour and a half. I don't know the exact
10:56:07 13 time.

10:56:09 14 Q Were you asked at your deposition the exact time the
10:56:12 15 meeting ran, or were you just asked if you remember how long
10:56:15 16 the meeting was?

10:56:16 17 A I answered I don't know. The answer I just gave you is
10:56:22 18 the same answer. I didn't know if it was an hour, hour and
10:56:25 19 a half, or what.

10:56:26 20 Q So you're saying that at your deposition your answer
10:56:29 21 was I don't know?

10:56:31 22 A I didn't know the exact length of the meeting.

10:56:35 23 Q And it's true that at your deposition what you actually
10:56:38 24 said was the answer is no; correct?

10:56:42 25 A The answer is I do not know the exact length of the

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10:56:45 1 meeting, and that's why I said no.

10:56:47 2 Q But you didn't include any of that qualification in
10:56:51 3 your deposition?

10:56:52 4 A No.

10:56:52 5 Q Okay. Were there any documents that you recall that
10:56:57 6 you reviewed or that were used at all in that November 14th
10:57:04 7 meeting besides the LSW Provider illustration and the
10:57:08 8 application?

10:57:09 9 A Did I review documents before? Is that what you're
10:57:14 10 asking?

10:57:15 11 Q With Ms. Walker were there any documents involved in
10:57:18 12 that November 14th meeting besides the illustration and the
10:57:21 13 application?

10:57:22 14 A I think that was the focal point of the meeting.

10:57:25 15 Q Okay. No other LSW marketing materials or anything
10:57:28 16 like that?

10:57:29 17 A I don't remember any.

10:57:29 18 Q And Mr. Botkin, he was present at that meeting;
10:57:33 19 correct?

10:57:34 20 A Yes.

10:57:34 21 Q And he was there as the meeting occurred with
10:57:40 22 Ms. Walker?

10:57:41 23 A Yes.

10:57:51 24 Q And Mr. Botkin, would you say he is a man of integrity?

10:57:56 25 A Yes.

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10:58:00 1 Q You have worked with him for a long time?

10:58:02 2 A About 12 years.

10:58:03 3 Q And you have never known him to be dishonest in any

10:58:06 4 way?

10:58:07 5 A No.

10:58:07 6 Q And you understand that he said in a statement that at

10:58:13 7 the meeting none of the things that Ms. Walker alleges

10:58:17 8 should be disclosed were actually disclosed to her; correct?

10:58:20 9 MR. SHAPIRO: Objection. Rank hearsay.

10:58:21 10 THE WITNESS: Not to my knowledge.

10:58:26 11 MR. FOSTER: There's lots of discussion about what

10:58:26 12 him and Mr. Botkin have talked about.

10:58:28 13 THE COURT: Overruled.

10:58:28 14 BY MR. FOSTER:

10:58:31 15 Q You don't recall being provided with a declaration that

10:58:34 16 Mr. Botkin offered that was sworn and related to this case?

10:58:39 17 A No.

10:58:43 18 MR. FOSTER: May I approach the witness, Your

10:58:44 19 Honor?

10:58:45 20 THE COURT: You may.

10:58:45 21 BY MR. FOSTER:

10:59:03 22 Q Do you see that's a declaration of Mr. Botkin?

10:59:06 23 MR. SHAPIRO: Do you have a copy?

10:59:08 24 MR. FOSTER: Sure.

10:59:09 25 BY MR. FOSTER:

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10:59:17 1 Q I'm sorry. Go ahead. Do you see that's a declaration
10:59:20 2 of Mr. Botkin?

10:59:21 3 A Yes.

10:59:21 4 Q And you were scheduled for a deposition in this action;
10:59:23 5 correct? Do you remember that?

10:59:25 6 A Yes.

10:59:26 7 Q And there was some discussion, you recollect, over
10:59:30 8 whether you would provide a declaration yourself for the
10:59:32 9 deposition; correct? Do you remember that?

10:59:34 10 A Yes.

10:59:35 11 Q And you eventually indicated that you would sit for a
10:59:38 12 declaration because you weren't willing to provide a
10:59:41 13 declaration like Mr. Botkin's which said that none of the
10:59:45 14 information that Ms. Walker alleges was not disclosed was
10:59:49 15 actually disclosed to her?

10:59:52 16 MR. SHAPIRO: Objection, Your Honor. Totally
10:59:53 17 improper.

10:59:54 18 THE COURT: Sustained.

11:00:01 19 Next question, please.

11:00:01 20 BY MR. FOSTER:

11:00:02 21 Q You have discussed the meetings that you and Mr. Botkin
11:00:05 22 both sat in on; correct?

11:00:07 23 A Yes.

11:00:13 24 Q And Mr. Botkin, he's expressed the view that the
11:00:22 25 subjects that Ms. Walker alleges should be disclosed about

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11:00:27 1 volatility defect, tax defect, guaranteed minimum fees,
11:00:31 2 monthly administrative charge, that those were never
11:00:34 3 disclosed or discussed to Ms. Walker; correct?

11:00:39 4 MR. SHAPIRO: Objection.

11:00:40 5 THE COURT: Sustained.

11:00:40 6 BY MR. FOSTER:

11:00:57 7 Q Now, you talked about topics that were covered with
11:01:05 8 Ms. Walker when Mr. Shapiro was questioning you; correct?

11:01:09 9 A Yes.

11:01:09 10 Q And you mentioned annuities; correct?

11:01:17 11 A Yes.

11:01:17 12 Q Isn't it true that annuities were never discussed with
11:01:22 13 Ms. Walker at the November 14th meeting?

11:01:27 14 A That would be correct, I believe.

11:01:28 15 Q Okay. So your only understanding about annuities comes
11:01:32 16 from what Mr. Botkin told you about his discussions with
11:01:34 17 Ms. Walker?

11:01:38 18 MR. SHAPIRO: Objection. Misstates his earlier
11:01:40 19 testimony.

11:01:41 20 THE COURT: Overruled.

11:01:41 21 BY MR. FOSTER:

11:01:42 22 Q Your understanding of the discussion about annuities
11:01:46 23 comes from what Mr. Botkin told you about his discussions
11:01:49 24 with Ms. Walker; correct?

11:01:50 25 A When Mike would finish his meetings, we would meet and

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11:01:54 1 that's where we would have our discussion on designing the
11:01:57 2 case and stuff like that. So that's how I heard that he had
11:02:00 3 the conversations with her.

11:02:01 4 Q So that understanding comes from discussions that you
11:02:04 5 had, oral conversations with Mr. Botkin; correct?

11:02:07 6 A Yes.

11:02:08 7 Q Similarly with real estate investments, that's never
11:02:13 8 anything that was discussed in that November 14 meeting;
11:02:16 9 correct?

11:02:18 10 A I believe that's correct.

11:02:19 11 Q So your only understanding of that comes from oral
11:02:23 12 conversations with Mr. Botkin; correct?

11:02:24 13 A Yes.

11:02:24 14 Q Now, when you talked about annuities, the annuities
11:02:36 15 discussed with Ms. Walker, they were discussed in the
11:02:39 16 context of her fully qualified IRAs, individual retirement
11:02:48 17 accounts; correct?

11:02:48 18 A Correct.

11:02:49 19 Q So that was an entirely different pot of money or
11:02:52 20 source of money than was being discussed for the LSW
11:02:57 21 product; correct?

11:02:58 22 A Yes.

11:03:02 23 Q But when you told the jury about all these alternatives
11:03:07 24 that Ms. Walker was presented with, you didn't tell them
11:03:10 25 that they were being presented for completely different

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11:03:14 1 sources of revenue. They weren't competing with each other
11:03:18 2 in any way; correct?

11:03:20 3 A I thought I made that clear.

11:03:22 4 Q You thought you made that clear?

11:03:24 5 A Yes. The annuities and the alternatives were for the
11:03:29 6 qualified plans.

11:03:32 7 Q And you talked about annuities and existence of indexed
11:03:39 8 annuities; correct?

11:03:40 9 A Yes.

11:03:41 10 Q Well, let me back up. Your understanding from what
11:03:45 11 Mr. Botkin told you is that Ms. Walker didn't want to use --
11:03:49 12 she didn't want to pull money out of her individual
11:03:53 13 retirement accounts to use on a new investment of annuities;
11:03:56 14 correct?

11:03:58 15 A No. That's not my understanding.

11:04:00 16 Q Okay. Well, let me ask you this about indexed
11:04:07 17 annuities in relation to the LSW product. For indexed
11:04:15 18 annuities I think you testified the index strategy is the
11:04:18 19 same; correct?

11:04:18 20 A The basic structure is the same, yes.

11:04:21 21 Q For indexed crediting; correct?

11:04:23 22 A Yes.

11:04:23 23 Q But the fees are different for indexed annuities as
11:04:27 24 compared to indexed universal life insurance; correct?

11:04:32 25 A They are totally different products. Yes.

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11:04:35 1 Q So, for example, indexed annuities don't have any cost
11:04:39 2 of insurance charges; correct?

11:04:42 3 A Correct.

11:04:51 4 MR. FOSTER: Would this be a good time to take a
11:04:54 5 break?

11:04:55 6 THE COURT: That's fine. We will take our second
11:05:00 7 break of the day, ladies and gentlemen.

11:05:29 8 (Jury not present)

11:05:31 9 MR. FOSTER: May we excuse the witness, Your
11:05:33 10 Honor?

11:05:34 11 THE COURT: You may be excused.

11:05:53 12 MR. FOSTER: Your Honor, with this witness we have
11:05:56 13 heard significant amounts in direct examination of hearsay
11:06:01 14 about what Mr. Botkin said or did not say to Ms. Walker. I
11:06:07 15 think that opens the door to a line of examination about the
11:06:10 16 fact that he's aware that Mr. Botkin has provided a sworn
11:06:14 17 declaration. He has seen it before. He has reviewed it and
11:06:17 18 he knows that Mr. Botkin maintains under penalty of perjury
11:06:22 19 that none of this information was disclosed.

11:06:24 20 MR. SHAPIRO: Your Honor, three things. First
11:06:25 21 off, I believe my questions were quite clear about the basis
11:06:28 22 for his knowledge, and that was that he actually worked with
11:06:32 23 Botkin to present the plan. That's number one.

11:06:34 24 Number two, it was all for his of mind what he
11:06:38 25 understood when he went back into the room and he was called

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11:06:42 1 in as a specialist to address this particular product on a
11:06:46 2 second pass. And he testified to just that.

11:06:48 3 Third, the issue with this affidavit is they went
11:06:49 4 to these gentlemen and said we will forgive you from
11:06:53 5 deposing if you sign this. One of them said: I want to be
11:06:55 6 heard. And the one who wanted to be heard is the one who's
11:06:55 7 testifying in this court today. So that's the back story to
11:07:05 8 this affidavit.

11:07:07 9 THE COURT: The ruling stands.

11:07:10 10 (Recess taken at 11:07 a.m.;
11:07:10 11 proceeding resumed at 11:22 a.m.)

11:07:11 12 (Jury present)

11:22:04 13 THE COURT: Mr. Foster.

11:22:05 14 MR. FOSTER: Thank you.

11:22:08 15 BY MR. FOSTER:

11:22:10 16 Q Mr. Stemler, we talked a little bit about back testing.
11:22:15 17 What do you mean by back testing?

11:22:16 18 A My understanding is that what the companies will do is
11:22:21 19 they take a look at the crediting method that's in force and
11:22:27 20 they compare if the product had existed 20, 30 years ago and
11:22:34 21 what would have been the crediting on the contract.

11:22:40 22 Q And that allows them to derive a maximum illustrated
11:22:43 23 rate; is that correct?

11:22:45 24 A That's correct.

11:22:45 25 Q In the case of Ms. Walker's policy, the maximum

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11:22:49 1 illustrated rate was 7.5 percent; correct?

11:22:53 2 A Correct.

11:22:54 3 Q And that was based on the historical performance of the
11:22:56 4 S&P 500; correct?

11:22:57 5 A Correct.

11:22:57 6 Q But you chose to use seven percent to be a little more
11:23:02 7 conservative; correct?

11:23:04 8 A Yes.

11:23:05 9 Q And your testimony was that you typically reduce the
11:23:06 10 maximum illustrated rate by .5 percent in the illustrations;
11:23:09 11 correct?

11:23:09 12 A Correct. Could be more.

11:23:11 13 Q But you reduce it a little bit from the maximum
11:23:14 14 illustrated rate; correct?

11:23:16 15 A Yes.

11:23:16 16 Q But the maximum illustrated rate is still the reference
11:23:19 17 point from which you reduce it; correct?

11:23:22 18 A No.

11:23:23 19 Q Well, you're starting with the maximum illustrated rate
11:23:26 20 and you're reducing it by a little bit; correct?

11:23:29 21 A Correct.

11:23:29 22 Q So you start with the back testing the company has done
11:23:31 23 about the historical performance of the S&P 500; correct?

11:23:36 24 A Yes.

11:23:36 25 Q And from that you reduce it a little bit to be a little

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11:23:39 1 more conservative in terms of the annual rate of return;
11:23:39 2 correct?

11:23:45 3 A That's correct.

11:23:45 4 Q So the number you portray in the illustration is still
11:23:48 5 related to the historical performance of the S&P 500;
11:23:51 6 correct?

11:23:51 7 A Yes.

11:23:52 8 Q When you reduce it a little bit, like down to
11:23:54 9 seven percent like you did in Ms. Walker's illustration,
11:23:57 10 you're still using a constant rate of return; correct?

11:24:01 11 A That's what's required on the illustration.

11:24:03 12 Q Okay. So LSW's illustration software doesn't allow you
11:24:08 13 to depict a volatile rate of return; correct?

11:24:12 14 A I don't think it has anything to do with LSW.

11:24:15 15 MR. FOSTER: Move to strike, Your Honor.

11:24:18 16 THE COURT: It will be stricken.

11:24:19 17 BY MR. FOSTER:

11:24:20 18 Q Did you understand the question, Mr. Stemler?

11:24:22 19 A Yes.

11:24:22 20 Q So the illustration software that LSW provides, as far
11:24:25 21 as you know, that doesn't allow you to depict volatile
11:24:29 22 non-constant rate; does it?

11:24:31 23 A No.

11:24:39 24 Q Now, I think you testified that the historical
11:24:42 25 performance of the S&P 500 is, quote, all we have to go on;

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11:24:46 1 correct?

11:24:47 2 A Yes.

11:24:48 3 Q But the historical performance of the S&P 500, that's a
11:24:51 4 volatile performance; it's not constant? Correct?

11:24:55 5 A Correct.

11:24:55 6 Q Now, you talked about the possibility that Ms. Walker
11:24:59 7 could decrease the amount of loans she took in the future.
11:25:02 8 Do you remember that?

11:25:03 9 A Yes.

11:25:04 10 Q Now, if Ms. Walker wanted to know the likelihood of the
11:25:08 11 success of the financial plan that was depicted in her
11:25:13 12 Provider illustration based on the premiums that she
11:25:18 13 anticipated to pay and based on the income withdrawals that
11:25:22 14 she anticipated taking out and as shown in the illustration,
11:25:25 15 if she wanted to know the probability that that financial
11:25:30 16 plan would succeed, wouldn't you have to assume that both
11:25:32 17 the premiums paid and the loans taken out were exactly what
11:25:37 18 was depicted in that illustration?

11:25:40 19 A I'm sorry. Say that again.

11:25:42 20 Q Sure. If she was asking the question of will the
11:25:45 21 financial plan depicted in this illustration succeed based
11:25:49 22 on the premiums that are shown and the loans taken out, you
11:25:53 23 would have to assume that the loans were taken out in the
11:25:56 24 amount depicted in the illustration; correct?

11:25:58 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:25:59 1 Q And you're familiar in comparing different types of
11:26:03 2 investment products, you wanted to freeze certain
11:26:06 3 assumptions to understand how they perform; correct?

11:26:09 4 A Correct.

11:26:09 5 Q So if you wanted to know the likelihood that the loans
11:26:13 6 would be taken out as illustrated in the illustration, you
11:26:16 7 would have to freeze the amount of those loans that were
11:26:19 8 shown in the illustration; correct?

11:26:21 9 A I would assume so.

11:26:24 10 Q That's pretty basic; right?

11:26:26 11 A I assume so.

11:26:27 12 Q And if she had to take less loans in the future, for
11:26:34 13 example, the policy would have been less valuable for her
11:26:38 14 than what was shown in the illustration because she would be
11:26:40 15 taking less loans; correct?

11:26:43 16 A It would be definitely less.

11:26:53 17 Q Now, when Ms. Walker filed a written complaint, you
11:26:57 18 prepared a response which sort of laid out the sequence of
11:27:00 19 events; correct?

11:27:01 20 A Yes.

11:27:04 21 Q And you tried to make that written response complete
11:27:07 22 and accurate; correct?

11:27:07 23 A Yes.

11:27:07 24 Q And there is nothing in it that you believe is
11:27:12 25 inaccurate; correct?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:27:13 1 A Not that I know of.

11:27:15 2 Q And the response lays out a timeline of events related

11:27:18 3 to Ms. Walker's claim; correct?

11:27:19 4 A Yes.

11:27:21 5 Q And you referenced the client log that we heard about

11:27:24 6 in developing the timeline; correct?

11:27:26 7 A Yes.

11:27:26 8 Q And it has detailed descriptions of the meetings

11:27:29 9 between Mr. Botkin and Ms. Walker; correct?

11:27:35 10 A Yes.

11:27:35 11 Q And it has a description of this November 14th, 2007,

11:27:39 12 meeting, the one that we were talking about; correct?

11:27:40 13 A I believe so.

11:27:41 14 Q And that was the only meeting that you attended with

11:27:47 15 Ms. Walker prior to the sale; correct?

11:27:49 16 A Correct.

11:27:51 17 Q In the description of the timeline that was in your

11:27:55 18 written complaint, nowhere in your description of that

11:28:00 19 November 14th meeting does it state anything about

11:28:01 20 disclosure of the guaranteed minimum values; does it?

11:28:07 21 A I have no idea.

11:28:08 22 Q Would it refresh your recollection to take a look?

11:28:10 23 A Sure.

11:28:15 24 Q There is one in your binder actually. If you look at

11:28:19 25 77. I don't want you to read it out loud, but just take a

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11:28:24 1 look and see if that refreshes your recollection at page
11:28:28 2 PRF0439.

11:28:33 3 A I'm sorry. What tab?

11:28:35 4 Q Tab 77. Do you have that there in your binder? It
11:28:40 5 should be at the front, I think.

11:28:41 6 A And which one?

11:28:43 7 Q Tab 77, if you go to PRF0439. Do you see that?

11:29:02 8 A Yes.

11:29:02 9 Q Does that refresh your recollection that your response
11:29:06 10 to the written complaint didn't say anything about
11:29:09 11 disclosing the calculation of the guaranteed values to
11:29:14 12 Ms. Walker?

11:29:15 13 A No.

11:29:15 14 Q It doesn't say anything about any of her other claims
11:29:18 15 in this case -- the monthly administrative charge reduction,
11:29:23 16 fees, volatility, tax consequences, being disclosed in there
11:29:27 17 either; does it?

11:29:28 18 A No.

11:29:30 19 Q Now, I want to talk to you about how you marketed the
11:29:34 20 policy to Ms. Walker. You used what's called a tax-free
11:29:39 21 retirement concept to market the policy to Ms. Walker;
11:29:42 22 correct?

11:29:43 23 A Yes.

11:29:43 24 Q And that tax-free retirement concept, that came out of
11:29:50 25 training that LSW conducted; correct?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:29:54 1 A Two years later.

11:29:56 2 Q Well, the tax-free retirement concept that you used
11:29:59 3 with Ms. Walker was the same as tax-free retirement concepts
11:30:02 4 that are used in LSW's trainings that you've been present
11:30:05 5 at?

11:30:05 6 A Yes.

11:30:06 7 Q And at the trainings that you have been present at,
11:30:09 8 there was a gentleman by the name of Mr. Kelly who was
11:30:11 9 present; correct?

11:30:13 10 MR. SHAPIRO: Objection, Your Honor. I think you
11:30:13 11 addressed this yesterday in the context of a different
11:30:13 12 event.

11:30:20 13 MR. FOSTER: I'm not sure what he's referring to,
11:30:21 14 Your Honor.

11:30:22 15 THE COURT: Proceed.

11:30:23 16 MR. FOSTER: Thank you.

11:30:23 17 BY MR. FOSTER:

11:30:23 18 Q In the trainings conducted by Mr. Kelly, he reviewed
11:30:28 19 his book about tax-free retirement and discussed how the
11:30:29 20 Provider policy could be used to produce tax-free retirement
11:30:29 21 income; correct?

11:30:30 22 A Yes.

11:30:36 23 Q And in the training he stated the Provider policy, that
11:30:38 24 could provide the tax benefits that are outlined in his book
11:30:38 25 correct?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:30:39 1 A Yes.

11:30:44 2 Q And LSW funded regional meetings held by AMS with
11:30:50 3 agents and paid for the rooms and lunch and the drinks where
11:30:53 4 Mr. Kelly spoke; correct?

11:30:54 5 A Yes.

11:30:55 6 Q In the meetings Mr. Kelly spoke to agents and he
11:30:57 7 featured the LSW product; correct?

11:31:01 8 MR. SHAPIRO: Objection, Your Honor. This is two
11:31:03 9 years later.

11:31:04 10 MR. FOSTER: I think there is foundation for this.

11:31:06 11 THE COURT: Lay the foundation.

11:31:07 12 MR. FOSTER: All right.

11:31:07 13 BY MR. FOSTER:

11:31:07 14 Q Now, did you use LSW's tax-free retirement marketing
11:31:12 15 concept with Ms. Walker?

11:31:14 16 A Yes.

11:31:16 17 Q Did you tell Ms. Walker under current law loans are
11:31:19 18 treated as tax free?

11:31:22 19 A That's correct.

11:31:22 20 Q And your meeting with Ms. Walker, that November 14
11:31:27 21 meeting, one thing that you do recall about that meeting is
11:31:30 22 that it was specifically focused on using the insurance as
11:31:35 23 supplemental retirement income; correct?

11:31:38 24 A Yes.

11:31:38 25 Q And the use of insurance for supplemental retirement

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11:31:42 1 income, that's the topic of these regional meetings paid for
11:31:47 2 by LSW featuring Mr. Kelly and the Provider product?

11:31:51 3 A That's part of it, yes.

11:31:53 4 Q And isn't it true that Provider policies need to remain
11:31:59 5 in force until the death of the insured to avoid tax
11:32:02 6 consequences of policy loans taken in excess of the basis of
11:32:08 7 the policy?

11:32:09 8 A Yes.

11:32:09 9 Q And if a Provider policy lapses with a loan
11:32:12 10 outstanding, that would be very negative for the
11:32:15 11 policyholder; correct?

11:32:16 12 A That's correct.

11:32:18 13 Q And the reason for that is that the loans would be
11:32:20 14 deemed what you referred to in your deposition as phantom
11:32:23 15 income; correct?

11:32:25 16 A Correct.

11:32:26 17 Q And what did you mean when you discussed phantom
11:32:27 18 income?

11:32:30 19 A If the loans are outstanding and the policy lapses, the
11:32:34 20 client doesn't have to pay the loan back because the
11:32:37 21 insurance company wouldn't have loaned the money they didn't
11:32:41 22 already secure, but it would be deemed income to the client.

11:32:46 23 Q And they would owe taxes on that income amount?

11:32:50 24 A Yes.

11:32:50 25 Q Do you know at what rate the taxes would be owed?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:32:54 1 A Whatever the ordinary income tax rate is.

11:32:57 2 Q And if a policyholder invested in a mutual fund and the
11:33:01 3 mutual fund went up in value and they took out money, do you
11:33:04 4 know what tax rate they would owe taxes on?

11:33:07 5 A If they're selling it off, it would probably be capital
11:33:11 6 gains.

11:33:12 7 Q And is the capital gains tax rate lower than the
11:33:15 8 ordinary income tax rate?

11:33:16 9 A Yes if it's long term. If it's short term, it's the
11:33:19 10 same.

11:33:20 11 Q Okay. But if it's over a year or so, it's lower;
11:33:22 12 correct?

11:33:22 13 A Correct.

11:33:23 14 Q So if a policyholder lapsed with a loan outstanding
11:33:27 15 with the Provider product and there was loans in excess of
11:33:31 16 the basis, they would owe taxes at a higher rate than if
11:33:35 17 they had invested in a mutual fund over a period of time and
11:33:39 18 there was a gain; correct?

11:33:40 19 A Yes.

11:33:40 20 Q And as we discussed before, LSW did not tell you any
11:33:45 21 information regarding the probability that the Provider
11:33:48 22 policy would remain in force until Ms. Walker's life
11:33:52 23 expectancy if she took loans as illustrated; correct?

11:33:57 24 A Correct.

11:33:58 25 Q Now, when Ms. Walker complained, isn't it true that you

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11:34:06 1 expressed the view that LSW had to take her complaint head
11:34:12 2 on or every producer for LSW would be faced with the same
11:34:17 3 assertion in the complaint?

11:34:20 4 A Yes.

11:34:21 5 MR. SHAPIRO: Objection, Your Honor. This is just
11:34:23 6 like Exhibit 408 yesterday.

11:34:26 7 THE COURT: Overruled.

11:34:26 8 BY MR. FOSTER:

11:34:28 9 Q And you expressed the view -- if we take a look at
11:34:34 10 Exhibit 80. Can you take a look at that in your binder.

11:34:36 11 A (Witness complies.)

11:34:42 12 Q Do you recognize that as an e-mail you sent to a number
11:34:45 13 of individuals at LSW?

11:34:46 14 A Uh-huh.

11:34:47 15 Q And you expressed the view that it was especially
11:34:49 16 important that Ms. Walker's complaint be dealt with
11:34:53 17 definitively in light of your, open parens, LSW, close
11:34:58 18 parens, desire to promote overfunding life insurance as a
11:35:03 19 source of retirement income?

11:35:04 20 A Yes.

11:35:05 21 Q Is that what you wrote? Do you recognize that?

11:35:08 22 A Yes.

11:35:11 23 MR. FOSTER: I would move Exhibit 80 into
11:35:12 24 evidence, Your Honor.

11:35:14 25 MR. SHAPIRO: No objection to this one, Your

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:35:14 1 Honor.

11:35:15 2 THE COURT: Exhibit 80 will be received.

11:35:18 3 MR. FOSTER: I would like to publish it, Your

11:35:20 4 Honor.

11:35:21 5 THE COURT: You may.

11:35:21 6 (Exhibit No. 80 received in evidence)

11:35:21 7 BY MR. FOSTER:

11:35:43 8 Q Is that the e-mail you wrote? Yes?

11:35:49 9 A Yes.

11:35:49 10 Q And LSW was promoting overfunding life insurance as a
11:35:54 11 source of retirement income; correct?

11:35:55 12 A It's one of the uses, yes.

11:35:59 13 Q And LSW was promoting that use; correct?

11:35:59 14 A Yes.

11:35:59 15 Q And you said that Ms. Walker's complaint takes this
11:36:02 16 concept head on; correct?

11:36:03 17 A Correct.

11:36:03 18 Q And that LSW needed to deal with it definitively;
11:36:05 19 correct?

11:36:06 20 A Yes.

11:36:08 21 Q And LSW's need to deal with it definitively, that's one
11:36:13 22 reason we are here a couple years later; correct?

11:36:16 23 A That I can't answer.

11:36:18 24 Q Fair enough. You also expressed the view that if
11:36:37 25 Ms. Walker's complaint wasn't dealt with, that the tax-free

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:36:41 1 retirement concept that LSW was marketing the policy with
11:36:46 2 was, quote, out the window; correct?

11:36:47 3 A I don't remember saying that, but I may have.

11:36:50 4 Q Would it refresh your recollection to look at 574 in
11:36:53 5 your binder? Do you recognize Exhibit 574 as an e-mail you
11:37:10 6 sent to Mike Duncan, an employee of National Life and LSW?

11:37:16 7 A Right.

11:37:21 8 MR. FOSTER: I would move 574 into evidence, Your
11:37:24 9 Honor.

11:37:26 10 MR. SHAPIRO: Your Honor, we object to 574.
11:37:29 11 Hearsay and hearsay within hearsay.

11:37:39 12 MR. FOSTER: Offering it for LSW's intent, Your
11:37:41 13 Honor.

11:37:43 14 MR. SHAPIRO: Your Honor, he can't achieve that
11:37:45 15 with this witness, I don't think.

11:37:48 16 MR. FOSTER: Well, this e-mail has gone to
11:37:50 17 employees at LSW, a number of them, telling them that --

11:37:57 18 THE COURT: Sir, if I want an argument, I will ask
11:37:59 19 you.

11:38:01 20 MR. FOSTER: Thank you, Your Honor.

11:38:14 21 THE COURT: Overruled, and 574 will be received.

11:38:18 22 MR. FOSTER: May I publish, Your Honor?

11:38:20 23 THE COURT: You may. Anytime an exhibit is in
11:38:22 24 evidence, you may publish without asking.

11:38:27 25 MR. FOSTER: Thank you.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:38:27 1 (Exhibit No. 574 received in evidence)

11:38:28 2 BY MR. FOSTER:

11:38:39 3 Q Do you remember that this e-mail is about Ms. Walker's
11:38:43 4 complaint; correct? Do you recall that?

11:39:06 5 A Yes.

11:39:06 6 Q And you wrote to LSW that the comments that there was
11:39:15 7 misrepresentation and a lack of full disclosure creates a
11:39:18 8 fundamental problem for all producers who rely on
11:39:22 9 illustrations provided by LSW/National Life. Since there
11:39:26 10 was never any question that the insured had full
11:39:30 11 illustrations, several, and signed the final illustration
11:39:32 12 upon policy delivery, the implication by Ms. Wilton is that
11:39:35 13 all the disclaimers, explanations, and various hypothetical
11:39:38 14 scenarios are no value.

11:39:39 15 And you go on to say: In my opinion this needs to
11:39:42 16 be addressed head on or no agent can ever place a policy and
11:39:46 17 rely on the illustration to be compliant and provide full
11:39:50 18 disclosure. Do you see that? Did I read that correctly?

11:39:54 19 A Yes.

11:39:54 20 Q That was the e-mail you sent to a number of individuals
11:39:57 21 at LSW?

11:39:57 22 A Yes.

11:39:58 23 Q Do you know whether LSW changed its illustrations in
11:40:01 24 any way in response to this e-mail?

11:40:04 25 A I have no idea.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:40:05 1 Q You're not aware of any changes in LSW's illustrations
11:40:08 2 in response to this e-mail?

11:40:12 3 A No.

11:40:12 4 Q And you're referring to a comment by Ms. Wilton. What
11:40:17 5 are you referring to there?

11:40:21 6 A That was somebody associated with the California
11:40:25 7 Department of Insurance, I believe.

11:40:27 8 Q And if we move up, there is other e-mails in the chain
11:40:35 9 between you and Mike Duncan. Who is Mike Duncan?

11:40:40 10 A He is the regional representative that calls on our
11:40:45 11 firm.

11:40:47 12 Q And you wrote to Mr. Duncan that if the view of the
11:40:58 13 individual at the Department of Insurance about Ms. Walker's
11:41:01 14 complaint was true, then tax-free retirement was out the
11:41:05 15 window; is that correct?

11:41:07 16 A Correct.

11:41:46 17 Q Now, we talked a little bit about your delivery --
11:41:54 18 actually before we talk about that, I have one question
11:42:03 19 about that document. Do you see where you say tax-free
11:42:08 20 retirement? Do you see how that's in all caps and in
11:42:11 21 quotation marks?

11:42:13 22 A Right.

11:42:14 23 Q Why is that?

11:42:19 24 A This was -- tax-free retirement was the term that
11:42:25 25 Patrick Kelly used with his book.

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11:42:29 1 Q And that was the marketing strategy used by LSW as
11:42:33 2 well; correct?

11:42:34 3 A Part of theirs.

11:42:37 4 Q And they used it with Mr. Kelly's book; correct?

11:42:42 5 A Yes.

11:42:42 6 Q So they sent copies of Mr. Kelly's book to you;
11:42:46 7 correct?

11:42:47 8 A Mr. Duncan was requested; he did not. I had to order
11:42:52 9 them separately.

11:43:03 10 Q Now, moving on to the guarantees of the policy, you
11:43:09 11 testified that you had a conversation with Ms. Walker about
11:43:14 12 the guarantees. Do you remember that?

11:43:15 13 A Yes.

11:43:16 14 Q And LSW never required you to disclose to policyholders
11:43:21 15 that the two percent guarantee is not provided every year;
11:43:24 16 correct?

11:43:26 17 A Not that I know of.

11:43:27 18 Q Okay. And you don't have any clue who started this
11:43:33 19 conversation you recounted about the guarantees; do you?

11:43:36 20 A No.

11:43:38 21 Q And you can't recall exactly the words that you used
11:43:42 22 when talking to Ms. Walker about the guarantees; can you?

11:43:45 23 A No.

11:43:47 24 Q And you can't recall anything that Ms. Walker
11:43:49 25 specifically said; can you?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:43:51 1 A No.

11:43:57 2 Q I think we looked at a page of Ms. Walker's

11:44:01 3 illustration before. This is the page of the illustration

11:44:12 4 that you went over with her; correct?

11:44:13 5 A Yes.

11:44:17 6 Q Is it fair to say there's a lot of notes on this page?

11:44:20 7 A Yes.

11:44:22 8 Q And there are notes about a lot of different things,

11:44:25 9 but there's no notes about five-year buckets on here; are

11:44:29 10 there?

11:44:30 11 A Not that I see.

11:44:31 12 Q And there's no notes about the guarantee being an

11:44:34 13 average retrospective calculation; are there?

11:44:39 14 A There are no notes to that effect.

11:44:42 15 Q Okay. You testified that you talked about the net

11:44:46 16 amount at risk with Ms. Walker; correct?

11:44:48 17 A Yes.

11:44:50 18 Q But isn't it true that you did not discuss anything

11:44:58 19 related to the net amount at risk in relation to how the

11:45:03 20 guarantee is was calculated for the Provider product?

11:45:06 21 A I don't understand the question.

11:45:07 22 Q Well, you understand that the cost of insurance charge

11:45:12 23 can be based on the net amount at risk; correct?

11:45:14 24 A Yes.

11:45:15 25 Q So if the policy value is lower, the net amount of risk

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11:45:20 1 goes up; correct?

11:45:22 2 A Yes.

11:45:23 3 Q And if the net amount at risk goes up, the cost of
11:45:27 4 insurance charges can be higher; correct?

11:45:28 5 A Yes.

11:45:29 6 Q And if there was a true annual guarantee provided, for
11:45:36 7 example, in a year where the S&P 500 returned -- let's say
11:45:43 8 in year one of the policy the S&P 500 returned zero percent.
11:45:48 9 If the product had a true annual guarantee of two percent,
11:45:52 10 in that scenario the policyholder would gain two percent;
11:45:56 11 correct? Would receive a credit of two percent?

11:45:59 12 A They would receive a credit of two percent.

11:46:01 13 Q But under the method that LSW uses to calculate the
11:46:04 14 guarantee, the policyholder would not receive any guaranteed
11:46:07 15 interest in that year; correct?

11:46:09 16 A Correct.

11:46:10 17 Q So comparing the true annual guarantees to the way that
11:46:13 18 LSW calculates the interest, isn't it true that all other
11:46:17 19 things being equal, a policyholder's cost of insurance
11:46:20 20 charges would be higher because their net of amount at risk
11:46:24 21 would be higher in the scenario that I described?

11:46:27 22 A In the scenario you described, yes.

11:46:30 23 Q And you didn't discuss anything related to that
11:46:32 24 scenario or its implications for guaranteed values on the
11:46:36 25 Provider product with Ms. Walker; did you?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:46:39 1 A No.

11:46:41 2 Q And you don't know whether LSW goes back and
11:46:44 3 recalculates the cost of insurance charge rate if the index
11:46:49 4 returns are below the guaranteed rate; do you?

11:46:51 5 A No.

11:46:52 6 Q When you spoke about that at your deposition, you said
11:46:55 7 the reason you don't understand it is because you don't
11:46:58 8 understand what LSW does internally; correct?

11:47:01 9 A Correct.

11:47:02 10 Q You don't have an understanding of what they're doing
11:47:05 11 internally with their crediting rates and mechanisms;
11:47:08 12 correct?

11:47:09 13 A That I do.

11:47:10 14 Q In regards to the net amount at risk and the guarantee?

11:47:14 15 A Net amount of risk, correct.

11:47:16 16 Q And since you don't understand that aspect of the
11:47:18 17 policy, this wasn't anything that you ever shared with
11:47:21 18 Ms. Walker?

11:47:22 19 A Correct.

11:47:29 20 Q Just a couple more things. You talked about a policy
11:47:33 21 delivery?

11:47:34 22 A Yes.

11:47:36 23 Q When you delivered the policy, wasn't Ms. Walker
11:47:38 24 standing in her office building in the lobby?

11:47:42 25 A I have no idea.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:47:43 1 Q Do you remember that meeting being about two minutes?

11:47:47 2 A No.

11:47:50 3 Q Is it fair to say that you don't remember ever going
11:47:52 4 over the buyer's guide with her at that policy delivery
11:47:57 5 meeting?

11:47:57 6 A No.

11:47:58 7 Q You talked about the annual statement, and Mr. Shapiro
11:48:04 8 had to refresh your recollection about the various meetings.
11:48:07 9 Isn't it true that you don't remember specifically what was
11:48:11 10 discussed with Ms. Walker about the annual statement?

11:48:14 11 A Other than we reviewed it.

11:48:17 12 Q Okay. You don't remember anything specifically that
11:48:20 13 she said?

11:48:20 14 A No.

11:48:24 15 Q The one thing that we do know is she asked how her
11:48:28 16 policy was performing; correct?

11:48:29 17 A Correct.

11:48:30 18 Q And there was a letter sent back to her, and it said
11:48:35 19 that the interest earned -- the interest earned is credited
11:48:39 20 to your policy each year on the 21st of January, and for
11:48:43 21 2008 it was zero; correct?

11:48:45 22 A Correct.

11:48:45 23 Q But isn't it true that even though the interest earned
11:48:50 24 was zero that year, her policy had actually declined in
11:48:53 25 value by about 15 to 20 percent in terms of its cash value?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:48:59 1 A Yes.

11:49:00 2 Q And your letter to her did not mention that, did it,

11:49:02 3 that we just looked at?

11:49:05 4 A She asked about the crediting.

11:49:10 5 Q Mr. Shapiro also showed you an annual statement that's

11:49:23 6 been marked as Exhibit 94, I believe. Do you remember he

11:49:32 7 asked you about the expense charges?

11:49:34 8 A Yes.

11:49:34 9 Q Now, I don't see any monthly administrative charge on

11:49:39 10 here. Do you see that?

11:49:43 11 A No.

11:49:44 12 Q Nowhere the monthly administrative charge is on this

11:49:46 13 annual statement?

11:49:50 14 A I don't see that.

11:49:55 15 Q Now finally, you mentioned a number of insurance

11:49:59 16 companies that you are licensed with; correct?

11:50:01 17 A Yes.

11:50:03 18 Q But if you wanted to get licensed by an insurance

11:50:05 19 company, you could do what's called activate when necessary;

11:50:09 20 correct?

11:50:10 21 A Yes.

11:50:12 22 Q And by activate when necessary, you mean that if there

11:50:15 23 is a policy you want to sell to a consumer and you're not

11:50:19 24 licensed as an agent with the company, the company then

11:50:22 25 licenses you; correct?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:50:23 1 A Yes.

11:50:23 2 Q And that process is instantaneous; correct?

11:50:27 3 A Yes.

11:50:27 4 Q It's done simultaneously with the policy you're selling

11:50:34 5 to a consumer?

11:50:36 6 A With the application.

11:50:36 7 Q With the application that's going in?

11:50:38 8 A Yes.

11:50:39 9 Q And there's no training that's required in any way with

11:50:42 10 that simultaneous licensing?

11:50:44 11 A We have to be qualified to sell insurance in the state

11:50:47 12 of California.

11:50:48 13 Q Okay. So as long as you have a general insurance

11:50:51 14 license in California, there is no additional requirements

11:50:54 15 when LSW imposes when it licenses you simultaneously?

11:51:00 16 A Initially, no.

11:51:01 17 Q Okay. And after you're licensed, there is no required

11:51:05 18 trainings that LSW does on its illustration system; are

11:51:08 19 there?

11:51:10 20 A No.

11:51:10 21 Q And they didn't require any training before you became

11:51:12 22 an agent with LSW?

11:51:14 23 A No.

11:51:14 24 Q They didn't require any training after you became an

11:51:18 25 agent with LSW?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:51:19 1 A No.

11:51:20 2 Q You testified that you have agents under you, but

11:51:23 3 you're also involved with some individual sales to

11:51:26 4 consumers; correct?

11:51:27 5 A Yes.

11:51:27 6 Q And you have been directly involved in the sale of

11:51:30 7 equity-indexed universal life policies; correct?

11:51:33 8 A Yes.

11:51:34 9 Q And those include sales of this Provider product;

11:51:37 10 correct?

11:51:38 11 A Yes.

11:51:38 12 Q And you have sold those to other consumers besides

11:51:42 13 Ms. Walker; correct?

11:51:43 14 A Yes.

11:51:43 15 Q And isn't it true at your deposition that when you were

11:51:46 16 asked whether you even remembered the name of a single other

11:51:51 17 policyholder that you had sold the Provider product to

11:51:53 18 besides Ms. Walker, you said no?

11:51:57 19 A Correct.

11:51:58 20 MR. FOSTER: No further questions, Your Honor.

11:52:03 21 THE COURT: Mr. Shapiro.

11:52:07 22 MR. SHAPIRO: Nothing from us, Your Honor.

11:52:09 23 THE COURT: Okay. Very good.

11:52:09 24 Sir, you may step down. Thank you.

11:52:18 25 MR. MARTENS: Your Honor, LSW calls Craig Smith.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:52:22 1 And while he's coming, I will publish a couple of documents
11:52:26 2 to the jury if that's okay.

11:52:27 3 THE COURT: That's fine.

11:52:45 4 MR. MARTENS: Your Honor, I think Mr. Brosnahan
11:52:46 5 published for the jury from Exhibit 131 the list of the top
11:52:52 6 ten premium payors that lapsed, and I just want to provide a
11:52:56 7 couple additional columns on that that weren't on the
11:53:02 8 exhibit that Mr. Brosnahan showed.

11:53:02 9 So, for example, with regard to Baldonado, the
11:53:02 10 premium payment was \$334,200, I believe. Mr. Brosnahan
11:53:11 11 showed that. What he didn't show was that the person was 54
11:53:15 12 years old and had a face amount of \$18 million. For each of
11:53:17 13 these individuals that was on Mr. Brosnahan's list, we have
11:53:17 14 the age and the face amount of the policy. So, for example,
11:53:17 15 Ms. Campos, who is 66 years old, she got a policy for a
11:53:17 16 million five almost, and that's the premium.

11:53:22 17 We just want to provide additional information for
11:53:22 18 each of those policyholders.

11:53:40 19 Additionally from Exhibit 131, I just wanted to
11:53:45 20 publish for the jury the 36 pages of lapsing policyholders
11:53:51 21 who paid premiums of a hundred dollars or less. I won't go
11:53:59 22 through all 36 pages, but Mr. Brosnahan can surely
11:54:00 23 double-check me on that. Gross premium column shows for
11:54:00 24 each person on these 36 pages that lapsed, they paid a
11:54:00 25 hundred dollars or less. Going all the way to page 36,

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:54:23 1 where the amount of premium goes down to as low as \$11.

11:54:44 2 THE CLERK: Sir, you are reminded that having been
11:54:48 3 previously sworn, you are still under oath. Do you
11:54:52 4 understand that?

11:54:52 5 THE WITNESS: Yes, I do.

11:54:55 6 THE CLERK: Please state your name for the record.

11:54:56 7 THE WITNESS: My name is Craig Allen Smith.

11:54:59 8 DIRECT EXAMINATION

11:54:59 9 BY MR. MARTENS:

11:54:59 10 Q Hello, Mr. Smith.

11:54:59 11 A Hello.

11:54:59 12 Q You and I have met before; correct?

11:55:01 13 A That's correct.

11:55:02 14 Q Where are you currently employed?

11:55:04 15 A I'm currently employed at National Life Insurance
11:55:10 16 Company in Montpelier, Vermont.

11:55:13 17 Q And you came out here to testify; is that correct?

11:55:13 18 A That's correct.

11:55:13 19 Q What's your title at National Life Insurance Company?

11:55:15 20 A My title is vice-president, strategic analysis and
11:55:19 21 appointed actuary.

11:55:22 22 Q Now, is National Life Insurance Company, the
11:55:25 23 organization with which you are employed, is that different
11:55:28 24 than LSW, Life Insurance Company of the Southwest?

11:55:33 25 A LSW is an another company, a distinct legal entity.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:55:39 1 However, it is one percent owned by National Life Insurance
11:55:43 2 Company.
11:55:44 3 Q And is National Life Insurance Company part of National
11:55:48 4 Life Group?
11:55:50 5 A Yes, it is.
11:55:50 6 Q Also based in Vermont?
11:55:51 7 A That's correct.
11:55:52 8 Q How long have you been with National Life?
11:55:54 9 A I have been with National Life for 31 years.
11:55:58 10 Q And I think you said your title was vice-president of
11:56:01 11 strategic analysis and appointed actuary?
11:56:04 12 A Yes.
11:56:04 13 Q So that means you're an actuary?
11:56:06 14 A Yes, it does.
11:56:08 15 Q What was your educational background?
11:56:10 16 A I graduated from the University of Illinois with a
11:56:16 17 bachelor of science degree in actuarial science.
11:56:20 18 Q And what year did you graduate from the University of
11:56:22 19 Illinois?
11:56:23 20 A 1981.
11:56:25 21 Q By my math that means you started at LSW around 1983?
11:56:30 22 A I started at National Life in 1983.
11:56:33 23 Q Sorry. Thank you for correcting me on that. So what
11:56:36 24 did you do between 1981 when you graduated and 1983 when you
11:56:40 25 joined National Life?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:56:42 1 A I worked as an actuary for Hewlett Associates, which
11:56:46 2 was a pension consulting firm.
11:56:49 3 Q And where was that located?
11:56:50 4 A I work in the Newport Beach, California, office.
11:56:53 5 Q So 33 years later you made it back?
11:56:56 6 A Here I am.
11:56:57 7 Q All right. Do you hold any professional designations
11:57:02 8 as actuary?
11:57:03 9 A Yes, I do.
11:57:03 10 Q What designations do you hold?
11:57:05 11 A I'm a Fellow of the Society of Actuaries, and I'm also
11:57:08 12 a member of the American Academy of Actuaries.
11:57:13 13 Q To be a Fellow in the Society of Actuaries, are there
11:57:17 14 requirements or prerequisites to joining that organization?
11:57:21 15 A Yes. Becoming a Fellow of the Society of Actuaries
11:57:25 16 required me to pass a series of actuarial exams.
11:57:33 17 Q How many exams?
11:57:35 18 A About ten.
11:57:35 19 Q Now, going back to 2005 and 2006, did you have the same
11:57:43 20 title at National Life?
11:57:46 21 A No, I did not.
11:57:47 22 Q What was your title back in 2005 and 2006?
11:57:51 23 A At that time my title was vice-president and chief
11:57:54 24 actuary.
11:57:56 25 Q What does that mean?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:57:57 1 A As chief actuary, in addition to actuarial
11:58:06 2 responsibilities such as being the appointed actuary, I
11:58:09 3 managed the corporate actuarial department at the company.

11:58:14 4 Q Can you explain to us what is the corporate actuarial
11:58:18 5 department.

11:58:18 6 A Yes. The corporate actuarial department is the
11:58:24 7 actuarial area that tends to work on financial matters such
11:58:31 8 as calculating reserves that are more related to the
11:58:37 9 accounting side of the house.

11:58:40 10 Q Is that different than the actuarial department where
11:58:44 11 Ms. MacGowan works?

11:58:45 12 A Yes, it is.

11:58:46 13 Q In what way is it different?

11:58:48 14 A The department Ms. MacGowan works is -- does work in
11:58:53 15 the areas of product development and pricing, and they tend
11:58:59 16 to work more with the marketing areas and the company's
11:59:04 17 distribution network.

11:59:06 18 Q So doing actuarial work for totally different issues?

11:59:12 19 A In general, yes.

11:59:13 20 Q When did you assume your current role as vice-president
11:59:16 21 of strategic analysis and appointed actuary?

11:59:19 22 A In 2012.

11:59:21 23 Q Now, are you familiar with the products known as
11:59:25 24 Paragon and Provider?

11:59:27 25 A Yes, I am.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

11:59:28 1 Q How are you familiar with those?

11:59:30 2 A I served as illustration actuary for those products
11:59:36 3 when they were introduced, and I'm also familiar with them
11:59:40 4 in my current role as appointed actuary.

11:59:44 5 Q Can you just tell the jury what it means when you say
11:59:46 6 you were the illustration actuary for Paragon and Provider
11:59:50 7 when they were launched.

11:59:52 8 A Yes, I can. Under state law there is an illustration
11:59:59 9 law which requires certification by an illustration actuary
12:00:05 10 that the scales used to illustrate non-guaranteed elements
12:00:09 11 meet the requirements of the law.

12:00:10 12 Q So when you say you have to certify the scales that are
12:00:15 13 used to illustrate non-guaranteed elements, can you put that
12:00:20 14 in little bit more layman's terms for the jury.

12:00:25 15 A Sure. Those scales would include things such as the
12:00:28 16 interest rate being illustrated to be credited on the
12:00:32 17 policies, the cost of insurance charges being made to the
12:00:39 18 policyholder to pay for the cost of providing the life
12:00:44 19 insurance benefit, and things like that.

12:00:47 20 Q So it's my understanding that with regard to the
12:00:50 21 non-guaranteed elements of an illustration, you have to make
12:00:53 22 this certification?

12:00:54 23 A The certification is done for the policy as a whole,
12:00:58 24 but it's done in the case the policy has non-guaranteed
12:01:02 25 elements.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:01:03 1 Q And one of the non-guaranteed elements might be, for
12:01:05 2 example, the interest rate used to illustrate current basis
12:01:08 3 B values?

12:01:09 4 A That's correct.

12:01:10 5 Q And when you're making this certification, what are you
12:01:12 6 certifying?

12:01:14 7 A I'm certifying that the scales used in the illustration
12:01:20 8 meet the requirements of the law.

12:01:22 9 Q When you say the requirements of the law, what law in
12:01:25 10 particular are you referring to?

12:01:27 11 A There is a specific law that in California is a law
12:01:33 12 pertaining to the illustration of life insurance policies.

12:01:37 13 Q Do you consider any other professional standards in
12:01:41 14 making such a certification?

12:01:43 15 A Yes, I do.

12:01:45 16 Q For example, what do you consider?

12:01:49 17 A As an actuary, we practice under a set of guidelines
12:01:56 18 known as actuarial standards of practice that we are obliged
12:01:59 19 to follow, and there is a specific actuarial standard of
12:02:05 20 practice related to policy illustrations.

12:02:09 21 Q Do you also consider the NAIC model regulation in
12:02:13 22 making a certification?

12:02:15 23 A Yes, I do.

12:02:16 24 Q In what way?

12:02:17 25 A Well, the model regulation is -- let me back up a

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12:02:23 1 second. The illustration filings are done in various
12:02:29 2 states, and typically a state will adopt what is known as
12:02:34 3 the model regulation that is developed by the NAIC.

12:02:40 4 The state of California -- in most states it's
12:02:45 5 adopted as a regulation. In the state of California
12:02:48 6 effectively the same regulation was adopted in the form of a
12:02:56 7 law.

12:02:57 8 Q Have you ever had a situation where you need to make a
12:03:00 9 certification with regard to a particular illustration, and
12:03:04 10 there is not a law directly on point to a particular issue?

12:03:11 11 A Yes, I have.

12:03:11 12 Q In that instance what do you do?

12:03:14 13 A In that instance I use my professional judgment to best
12:03:18 14 meet the spirit of which was intended by the law.

12:03:22 15 Q Do you look to related regulations or standards of
12:03:24 16 practice to try to exercise that judgment?

12:03:28 17 A Yes, I do.

12:03:28 18 Q Would that include the model regulation?

12:03:30 19 A Yes, it would.

12:03:31 20 Q I would like to show you Exhibit 226. I'm going to
12:03:37 21 give you a binder.

12:03:47 22 MR. MARTENS: May I approach, Your Honor?

12:03:49 23 THE COURT: You may.

12:03:50 24 BY MR. MARTENS:

12:04:00 25 Q It's a relatively thin binder, so that's a little

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:04:02 1 unique in this case. Do you have it there in front of you?

12:04:04 2 A I do.

12:04:05 3 Q Have you been able to find Exhibit 226?

12:04:07 4 A Yes, I have.

12:04:10 5 Q I think 226 is in evidence, so why don't we put it up
12:04:15 6 on screen so the jury can follow along.

12:04:28 7 Do you recognize Exhibit 226?

12:04:30 8 A Yes, I do.

12:04:31 9 Q What is it?

12:04:34 10 A It is my -- it is the illustration actuary
12:04:37 11 certification that I provided upon the introduction of the
12:04:40 12 Provider policy.

12:04:41 13 Q And if we just go to the second page -- in fact, it
12:04:51 14 might be just easier if we use the elmo on this one since
12:04:54 15 it's a small document.

12:04:57 16 Is this Exhibit 226 on the screen here?

12:05:00 17 A Yes, it is.

12:05:02 18 Q And there is a signature on the back?

12:05:07 19 A Yes.

12:05:07 20 Q That's yours?

12:05:08 21 A That's correct.

12:05:09 22 Q Back in 2005?

12:05:11 23 A That's correct.

12:05:11 24 Q And it indicates that you were the illustration actuary
12:05:14 25 for LSW?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:05:16 1 A That's correct.

12:05:18 2 Q And then -- so what's the purpose of Exhibit 226?

12:05:25 3 A The purpose of Exhibit 226 was to certify that the
12:05:37 4 illustrations of LSW complied with the illustration
12:05:42 5 regulation.

12:05:43 6 Q And in particular the illustration for the Provider
12:05:45 7 product?

12:05:45 8 A That's correct.

12:05:47 9 Q Now, I have highlighted here on the middle of this page
12:05:50 10 some language. Can you read what that says.

12:05:52 11 A Yes. The disciplined current scales for these plans
12:05:57 12 are in conformity with the actuarial standard of practice
12:06:02 13 for compliance with the NAIC life insurance illustration
12:06:04 14 model regulation, ASOP-24, promulgated by the Actuarial
12:06:12 15 Standards Board.

12:06:13 16 Q Is that what you were referring to earlier when you
12:06:15 17 said that you had to certify compliance of the disciplined
12:06:17 18 current scale?

12:06:20 19 A Yes, it is.

12:06:20 20 Q Including the interest rate that would be used to
12:06:22 21 credit the current basis B interest on the illustration?

12:06:27 22 A That's correct.

12:06:28 23 Q You were certifying that it was done in conformance
12:06:32 24 with the regulations?

12:06:33 25 A That's correct.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:06:36 1 Q Now, I think down below there's a sentence in the next
12:06:40 2 paragraph that begins "however." Do you see that?

12:06:42 3 A Yes, I do.

12:06:43 4 Q Could you just read that for the jury.

12:06:45 5 A However, the regulation and ASOP-24 were developed
12:06:51 6 before equity-indexed universal life products emerged in the
12:06:57 7 marketplace. It is not possible to provide meaningful
12:07:00 8 illustrations of such products that are fully in accordance
12:07:03 9 with the regulation.

12:07:05 10 Q Can you explain to the jury what that means.

12:07:08 11 A The illustration regulation was developed prior to the
12:07:12 12 emergence in the marketplace of indexed universal life
12:07:18 13 products, and the wording of the regulation was written in
12:07:22 14 such a way that it clearly assumed that for a life insurance
12:07:31 15 product, the company will have declared a fixed rate of
12:07:37 16 interest to be credited for the policyholder in a given
12:07:41 17 here.

12:07:42 18 It did not contemplate the possibility of a
12:07:46 19 product such as the indexed universal life product where the
12:07:51 20 interest to be credited to the policyholder would depend
12:07:55 21 upon something like the movement of the S&P 500 index.

12:07:59 22 Q Now, this Exhibit 226 is being sent to whom?

12:08:03 23 A This is being sent to the state regulators.

12:08:06 24 Q In California?

12:08:07 25 A In California, yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:08:09 1 Q So why did you include this sentence in here explaining
12:08:13 2 to the state of California that the regulation didn't apply
12:08:16 3 precisely?

12:08:17 4 A Because the regulation did not apply precisely, and it
12:08:25 5 was not precisely clear what to do in terms of illustrating
12:08:30 6 for a product such as indexed universal life. What I did
12:08:36 7 was first apply my professional judgment to meet the spirit
12:08:42 8 and intent of the regulation or, in the case of California,
12:08:46 9 the law, to the extent possible. But in doing so, I wanted
12:08:54 10 to make sure that I disclosed to the regulator exactly what
12:09:00 11 we were doing, given this situation.

12:09:04 12 Q Can you read after the sentence that's highlighted the
12:09:07 13 next sentence that begins "with regard" through the end of
12:09:10 14 the paragraph.

12:09:11 15 A Yes. With regard to the ASOP where a question arises
12:09:18 16 with regard to the applicability of a standard of practice
12:09:20 17 or where no applicable standard exists, an actuary is
12:09:26 18 directed to use professional judgment taking into account
12:09:29 19 generally accepted actuarial principles and practices.

12:09:34 20 Consistent with this charge, it is the opinion of
12:09:36 21 the undersigned that when provided in conjunction with
12:09:39 22 appropriate disclosure, these illustrations comply with the
12:09:43 23 spirit and intent of the stated goals of the regulation to
12:09:46 24 ensure that illustrations do not mislead purchasers of life
12:09:50 25 insurance and to make illustrations more understandable.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:09:54 1 Q Was that in fact your intent back in 2005 when you
12:09:58 2 signed as illustration actuary for the Provider product?
12:10:01 3 A Yes, it was.
12:10:02 4 Q Was it your intent to comply with both the spirit and
12:10:06 5 intent of the regulation?
12:10:06 6 A Yes, it was.
12:10:09 7 Q Do you believe you did that?
12:10:10 8 A Yes, I do.
12:10:11 9 Q Do you still believe that today?
12:10:12 10 A Yes, I do.
12:10:13 11 Q Did you continue to be the illustration actuary for the
12:10:17 12 Provider product after 2005?
12:10:20 13 A Yes, I did.
12:10:20 14 Q Were there continuing obligations in that role each
12:10:23 15 year?
12:10:23 16 A Yes, there were.
12:10:25 17 Q Including what?
12:10:26 18 A Including an annual certification to the regulator that
12:10:28 19 the illustrations continued to be in compliance with the
12:10:31 20 illustration law and regulation.
12:10:32 21 Q Did you make those certifications each year?
12:10:34 22 A Yes, I did.
12:10:35 23 Q Did you believe them to be true?
12:10:37 24 A Yes, I did.
12:10:38 25 Q Did you act at all times in good faith?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:10:41 1 A Yes, I did.

12:10:42 2 Q How long did you continue in that role as illustration
12:10:45 3 actuary providing certifications for the Provider product?

12:10:47 4 A I continued in that role until 2011.

12:10:51 5 Q So any policies sold between 2005 and 2011, Provider
12:10:57 6 policies, would have been sold based in part on your
12:11:00 7 certification?

12:11:00 8 A That's correct.

12:11:04 9 Q Now, it also says -- at the bottom of this page there
12:11:07 10 are two additional sentences. Do you see that?

12:11:11 11 A Yes, I do.

12:11:11 12 Q Could you read the first sentence for the jury.

12:11:15 13 A Yes. Non-guaranteed elements illustrated for new
12:11:18 14 policies are consistent with those illustrated for similar
12:11:21 15 in-force policies.

12:11:24 16 Q What's the purpose of that part of the certification?

12:11:26 17 A The purpose is there is an obligation to disclose if
12:11:36 18 the case is that you are illustrating something that is not
12:11:42 19 consistent with a similar in-force policy.

12:11:46 20 Q So this relates to non-guaranteed elements; is that
12:11:51 21 fair?

12:11:51 22 A Yes.

12:11:52 23 Q So are you saying if you're doing something in this
12:11:55 24 product, Provider, that's not consistent with what you're
12:12:00 25 doing on a non-guaranteed basis in another product, you need

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:12:04 1 to say so?

12:12:06 2 MR. BROSNAHAN: Objection. Leading.

12:12:07 3 THE COURT: Rephrase the question.

12:12:07 4 BY MR. MARTENS:

12:12:08 5 Q If you're doing something different with a similar
12:12:12 6 product on a non-guaranteed basis, are you required to
12:12:16 7 disclose that?

12:12:17 8 A Yes, we are.

12:12:18 9 Q Are you certifying here whether or not there is
12:12:21 10 anything to disclose?

12:12:22 11 A I'm certifying that there is nothing to disclose in
12:12:26 12 that regard.

12:12:26 13 Q Now, it refers to similar in-force policies. Do you
12:12:30 14 see that?

12:12:30 15 A Yes, I do.

12:12:31 16 Q Did you at the time have to determine whether there
12:12:33 17 were similar in-force policies?

12:12:36 18 A I did not have to determine that.

12:12:38 19 Q Why not?

12:12:39 20 A Because the disclosure is required in the event that
12:12:44 21 there are inconsistencies with similar in-force policies. I
12:12:49 22 had the knowledge that there were no inconsistencies with
12:12:53 23 any policies that could plausibly be considered to be a
12:12:59 24 similar policy; therefore, I concluded there was nothing to
12:13:03 25 disclose.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:13:03 1 Q In other words, you just determined whether there were
12:13:05 2 inconsistencies with anything that might even possibly be
12:13:09 3 similar?

12:13:09 4 A That's correct.

12:13:10 5 Q And you didn't think there were any inconsistencies?

12:13:13 6 A That's correct.

12:13:13 7 Q So you didn't have to sort out whether there was
12:13:17 8 something similar?

12:13:18 9 A That's correct.

12:13:18 10 Q Now, on the next sentence, can you read that.

12:13:19 11 A Yes. Illustrated non-guaranteed elements for new and
12:13:27 12 in-force policies subject to this regulation are consistent
12:13:30 13 with the non-guaranteed elements amounts actually credited
12:13:33 14 or charged to the same or similar forms.

12:13:36 15 Q Can you explain to us what you're doing in this
12:13:39 16 sentence.

12:13:39 17 A Yes. That expands -- it's pretty much the same concept
12:13:51 18 as the sentence before, but it expands it to include
12:13:55 19 in-force policies subject to the regulation and not
12:13:59 20 necessarily limited to new policies as the first sentence
12:14:02 21 is.

12:14:03 22 Q So the first sentence refers to illustrated elements
12:14:07 23 for new policies?

12:14:08 24 A Yes.

12:14:09 25 Q And the second one refers to in-force policies?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:14:12 1 A In-force policies or new policies, yes.

12:14:16 2 Q What is an in-force policy?

12:14:18 3 A An in-force policy is generally viewed to be a policy

12:14:21 4 that was issued more than a year ago.

12:14:27 5 Q And how did you -- well, where does the requirement

12:14:29 6 that this certification be made come from?

12:14:35 7 A The requirement of disclosing any inconsistencies comes

12:14:40 8 from the illustration regulation and law.

12:14:44 9 Q Similarly, with regard to this sentence did you need to

12:14:47 10 determine whether there were same or similar forms?

12:14:49 11 A No, I did not.

12:14:50 12 Q Why not?

12:14:53 13 A It was the same reasoning as for the first sentence.

12:14:53 14 Q Meaning you knew there were no inconsistencies whether

12:15:00 15 the form was similar or not?

12:15:02 16 A That's correct.

12:15:02 17 Q That language in that second sentence, did you make up

12:15:05 18 that language?

12:15:06 19 A No, I did not.

12:15:07 20 Q Where did that language in the second sentence actually

12:15:10 21 come from?

12:15:10 22 A I used the language that was provided within a life

12:15:15 23 practice note that I obtained from the American Academy of

12:15:21 24 Actuaries.

12:15:21 25 Q What do you mean by a life practice note?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:15:24 1 A A life practice note is something written by groups
12:15:30 2 within the American Academy of Actuaries to offer guidance
12:15:39 3 to actuaries practicing in a given field.
12:15:41 4 Q Do those life practice notes provide guidance as to how
12:15:44 5 to make the specific certification required in this
12:15:47 6 sentence?
12:15:48 7 A This particular life practice note did provide a
12:15:53 8 language -- an example of the wording of the certification
12:15:58 9 that an actuary could use, and I followed that wording.
12:16:01 10 Q How closely did you follow the wording from that
12:16:05 11 actuarial practice note in writing this sentence? How
12:16:08 12 closely did you follow it?
12:16:09 13 A I followed their wording word for word.
12:16:12 14 Q So, for example, where it says in the next to the last
12:16:16 15 line are consistent with the non-guaranteed elements amounts
12:16:20 16 actually credited, did you actually, even that awkward
12:16:22 17 phrasing, copy exactly from the practice note?
12:16:26 18 A Yes, I did.
12:16:27 19 MR. BROSNAHAN: Objection. Best evidence rule,
12:16:27 20 Your Honor.
12:16:31 21 THE COURT: Overruled.
12:16:32 22 BY MR. MARTENS:
12:16:35 23 Q Your answer?
12:16:35 24 A My answer was yes, I did.
12:16:36 25 Q Do you have any concerns about the accuracy of this

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:16:38 1 document at all?

12:16:39 2 A No, I do not.

12:16:45 3 Q Now I would like to show you Exhibit 225 from your
12:16:48 4 binder. Do you recognize Exhibit 225?

12:17:02 5 A Yes, I do.

12:17:03 6 Q What is Exhibit 225?

12:17:05 7 A 225 is the illustration actuary certification for the
12:17:11 8 initial submission of the Paragon product.

12:17:18 9 Q And the signatory on the certification is whom?

12:17:22 10 A That's me.

12:17:23 11 Q And does it state that you're the illustration actuary
12:17:26 12 for LSW for this product?

12:17:29 13 A Yes, it does.

12:17:30 14 Q The date of the signature?

12:17:31 15 A December 19, 2006.

12:17:34 16 Q So were you the illustration actuary only in the 2006
12:17:40 17 year for the Paragon product or for subsequent years as
12:17:43 18 well?

12:17:43 19 A I was the illustration actuary for the Paragon product
12:17:47 20 starting in 2006 through the beginning of 2011.

12:17:53 21 Q And similarly to the Provider product, did you have to
12:17:58 22 make a certification each year?

12:17:59 23 A Yes, I did.

12:18:00 24 Q So if a Paragon product was sold between 2006 and 2011,
12:18:05 25 it was based on your certification as an illustration

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:18:07 1 actuary?

12:18:08 2 A Yes, it was.

12:18:09 3 Q With regard to this Paragon certification, did you at

12:18:12 4 all times act in good faith in making this certification?

12:18:16 5 A Yes, I did.

12:18:17 6 Q Did you consider your professional obligations as an

12:18:19 7 actuary?

12:18:20 8 A Yes, I did.

12:18:21 9 Q Did you consider the relevant model regulations?

12:18:23 10 A Yes, I did.

12:18:24 11 Q Did you consider the relevant California state law?

12:18:27 12 A Yes, I did.

12:18:28 13 Q Did you at the time you signed it believe you were

12:18:31 14 complying with all of those laws in making that

12:18:34 15 certification?

12:18:36 16 A Yes, I did.

12:18:36 17 Q And is that true with regard to Provider as well?

12:18:38 18 A Yes.

12:18:38 19 Q Do you have any doubt about whether you were accurate

12:18:40 20 in making this certification back in 2006?

12:18:44 21 A I fully believe I was accurate in making that

12:18:47 22 certification.

12:18:48 23 Q Again, we could go through all of the relevant

12:18:52 24 paragraphs, and I'm sure it would be as exciting the second

12:18:57 25 time through as the first time. But is it fair to say that

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:19:00 1 all the same language that we just looked at with regard to
12:19:05 2 the Provider certification is in the Paragon one as well?
12:19:08 3 A Yes, it is.
12:19:32 4 Q I think there was some questioning in this trial about
12:19:33 5 an Exhibit 227. I'm going to show you Exhibit 227. You can
12:19:55 6 flip to it in your binder. I will put it up on the elmo as
12:19:57 7 well for the benefit of everyone else in the courtroom.
12:20:03 8 Just let me know when you're there?
12:20:05 9 A I don't see it in my binder.
12:20:08 10 Q 227?
12:20:11 11 A Correct.
12:20:11 12 Q Well, we will just use the one up on the screen, then.
12:20:15 13 Okay? Make it go a little easier; all right? And we'll
12:20:15 14 look to see if we can get you a copy as well.
12:20:21 15 Do you recognize this exhibit?
12:20:22 16 A Yes, I do.
12:20:23 17 Q Is it an e-mail to you from a Brett Anderson?
12:20:27 18 A That's a part of it, yes.
12:20:29 19 Q Down at the bottom?
12:20:30 20 A Yes.
12:20:32 21 Q Can you just read Brett Anderson's e-mail address.
12:20:38 22 A It looks like BrettAnderson1@gmail.com.
12:20:45 23 MR. MARTENS: If I can approach, Your Honor?
12:20:52 24 THE COURT: You may.
12:20:52 25 MR. MARTENS: We'll keep a copy up on the screen

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:20:52 1 for everybody else.

12:20:52 2 BY MR. MARTENS:

12:20:53 3 Q So this BrettAnderson1@gmail.com begins his e-mail to
12:20:53 4 you in February of 2010 with the salutation: Hi, Craig. Do
12:21:17 5 you see that?

12:21:18 6 A I see that.

12:21:19 7 Q Were you in 2010 on a first-name basis with
12:21:22 8 Mr. Anderson?

12:21:23 9 A No, I was not.

12:21:25 10 Q Do you even know who Brett Anderson is?

12:21:28 11 A No, I do not.

12:21:29 12 Q Do you have any idea how he got your e-mail address?

12:21:32 13 A No, I do not.

12:21:33 14 Q So you get this e-mail. What did you do with it?

12:21:37 15 A I quickly reviewed the content of the e-mail. I was
12:21:46 16 able to quickly determine that the subject matter was
12:21:50 17 properly in Elizabeth's MacGowan's area and not my own, so I
12:21:58 18 forwarded the e-mail to Elizabeth.

12:22:00 19 Q And I think you said the other day you made a
12:22:02 20 light-hearted comment when you forwarded it to her?

12:22:07 21 A Yes, I did.

12:22:08 22 Q Why did you forward it to Ms. MacGowan -- let me
12:22:09 23 rephrase. did you have any concerns that Ms. MacGowan would
12:22:15 24 address this e-mail if it needed to be addressed?

12:22:19 25 A I had full confidence that Ms. MacGowan would address

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:22:23 1 the e-mail if it needed to be addressed.

12:22:26 2 Q Have you had a chance since 2010 to go back and look at

12:22:31 3 the letter attached to the e-mail?

12:22:33 4 A Yes, I have.

12:22:33 5 Q Was that in the course of this litigation?

12:22:35 6 A Yes, it was.

12:22:36 7 Q And having looked through that letter that's attached

12:22:40 8 to the e-mail, I think we saw the other day that there is

12:22:42 9 some allegations made by this Brett Anderson1@gmail.com who

12:22:50 10 you don't know?

12:22:51 11 A Correct.

12:22:52 12 Q And have you been able to look over those allegations?

12:22:55 13 A Yes, I have.

12:22:55 14 Q Including allegations that there's errors in your

12:22:58 15 illustrations?

12:22:59 16 A I have looked over them, yes.

12:23:00 17 Q And based on looking over those allegations, do you

12:23:04 18 have any opinion about the accuracy of the allegations?

12:23:07 19 A Yes, I do.

12:23:08 20 Q And what is that?

12:23:09 21 A I believe his allegations are totally inaccurate.

12:23:13 22 Q Why do you say that?

12:23:14 23 A It is based on analysis that he did that is badly

12:23:22 24 flawed.

12:23:23 25 Q Is it based on a misunderstanding of how the products

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:23:28 1 work based on your reading of the e-mail?

12:23:31 2 A Yes, it is.

12:23:32 3 Q Have you ever heard anybody describe Brett Anderson
12:23:35 4 around the office?

12:23:36 5 A Not that I can recall.

12:23:38 6 Q You haven't heard the description that he's a type of
12:23:40 7 person who is always certain but rarely correct?

12:23:44 8 A I don't recall hearing that.

12:23:55 9 Q I think there is one more exhibit I want to show you,
12:23:59 10 Exhibit 87. I'm just going to put this one up on the
12:24:12 11 screen. I don't think we have your binder from the other
12:24:16 12 day.

12:24:18 13 So Exhibit 87, I'll just start on the front page.
12:24:22 14 Do you recognize this as the California state filing for the
12:24:24 15 Provider product?

12:24:32 16 A Let's see.

12:24:38 17 Q Why don't I bring it up to you so you can take a look.

12:24:38 18 A Sure. Okay.

12:24:42 19 MR. MARTENS: May I approach, Your Honor?

12:24:44 20 THE COURT: You may.

12:24:45 21 BY MR. MARTENS:

12:25:05 22 Q Do you recognize that as the California state filing
12:25:07 23 for the Provider product?

12:25:08 24 A Yes, it is.

12:25:09 25 Q Did you have some involvement with that filing?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:25:14 1 A Yes, I did.

12:25:14 2 MR. MARTENS: Your Honor, just in case the witness
12:25:14 3 has some trouble, I'm going to leave that copy up there.

12:25:14 4 THE COURT: That's fine.

12:25:14 5 BY MR. MARTENS:

12:25:28 6 Q I would like you to turn to the page Bates number
12:25:33 7 ending in 147. Are you there?

12:25:47 8 A I am.

12:25:48 9 Q I'm going to put it up here on the screen as well.

12:25:51 10 Do you know what this document is?

12:25:55 11 A Yes, I do.

12:25:56 12 Q What is it?

12:25:57 13 A It is a document speaking to the reserve methodology
12:26:06 14 and computations that would be done on the Provider product.

12:26:13 15 Q And can you just explain to the jury what it means to
12:26:16 16 have a reserve methodology and computation.

12:26:19 17 A Yes. For life insurance policies, we as an insurance
12:26:26 18 company are required to hold reserves under the state law to
12:26:34 19 provide for the future payment of benefits under the
12:26:38 20 policies. So this memo would be speaking to the regulator
12:26:43 21 about how the reserves for the Provider product are to be
12:26:48 22 calculated.

12:26:49 23 Q So this is about how you determine whether there is
12:26:56 24 enough money being held at the company to make sure you can
12:26:59 25 pay the policyholders?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:27:00 1 A How we determined that we are holding the appropriate
12:27:04 2 level of reserves, yes.
12:27:05 3 Q And is that a matter of, again, state regulation, how
12:27:08 4 much money needs to be held?
12:27:10 5 A Yes, it is, right. Regulation and law.
12:27:12 6 Q And there is a signature down at the bottom. Do you
12:27:14 7 see that?
12:27:15 8 A Yes, I do.
12:27:15 9 Q Whose signature is that?
12:27:17 10 A That would be mine.
12:27:18 11 Q And the date again?
12:27:20 12 A The date is March 30, 2005.
12:27:25 13 Q Do you remember that there were some questions the
12:27:28 14 other day about stochastic analysis?
12:27:34 15 A Yes, I do.
12:27:37 16 Q Is there some type of stochastic analysis that goes
12:27:41 17 into making this certification?
12:28:16 18 A I'm not seeing it on this particular document.
12:28:20 19 Q Well, there would be a reason for that, and that's
12:28:25 20 because I showed you the wrong page.
12:28:28 21 A Okay.
12:28:28 22 Q So why don't we get you on the right page. Turn to
12:28:30 23 page 153, which I will put up on the screen. Do you see
12:28:40 24 page 153?
12:28:41 25 A Yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:28:42 1 Q What is page 153?

12:28:45 2 A Page 153 is the final page of a document titled indexed
12:28:55 3 interest crediting and investment procedures for
12:28:58 4 equity-indexed universal life pertaining to the Provider
12:29:02 5 product.

12:29:04 6 Q Can you just tell us in layman's terms what that means.

12:29:07 7 A Yes. It was a memo to the regulators included within
12:29:13 8 the filing to describe to them how we credited interest on
12:29:19 9 the Provider product and how we planned to invest for the
12:29:25 10 Provider product.

12:29:26 11 Q Again, this is all part of the state filing that is
12:29:29 12 Exhibit 87?

12:29:31 13 A That's correct.

12:29:31 14 Q Who is the signatory on this document?

12:29:33 15 A That is me.

12:29:35 16 Q And what's the date?

12:29:36 17 A March 30, 2005.

12:29:39 18 Q And there is a section on page that ends in Bates
12:29:41 19 number 153 that refers to asset adequacy testing?

12:29:47 20 A That's correct.

12:29:48 21 Q And there were some questions I believe when you
12:29:52 22 previously testified about the section that deals with
12:29:53 23 randomized economic scenarios?

12:29:58 24 A That's correct.

12:29:59 25 Q What is the purpose of that part of the certification?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:30:02 1 A That part of the certification speaks to part of what
12:30:06 2 we do in ensuring that the reserves we are holding for these
12:30:12 3 products meet the requirement of the law.

12:30:16 4 Q When it talks about economic scenarios that are
12:30:19 5 randomized, do you see that in the second sentence under
12:30:22 6 asset adequacy testing?

12:30:24 7 A Yes, I do.

12:30:25 8 Q Is that a Monte Carlo analysis?

12:30:27 9 A I do not consider it to be, no.

12:30:30 10 Q Is there any effort made in this type of testing to
12:30:32 11 project the probability that the S&P 500 will perform in any
12:30:36 12 way in the future?

12:30:38 13 A No, there is not.

12:30:39 14 Q Is projections about likelihoods any part of this
12:30:44 15 analysis?

12:30:45 16 A No, it is not.

12:30:47 17 Q Is Monte Carlo any part of this analysis?

12:30:49 18 A No, it is not.

12:30:50 19 Q Is it a stochastic analysis?

12:30:52 20 A Yes, it is.

12:30:53 21 Q What does that mean?

12:30:54 22 A Stochastic in my mind is more or less just a different
12:31:00 23 fancier way to say randomized.

12:31:05 24 Q Is the type of stochastic analysis that is conducted
12:31:05 25 for purposes of this certification the type of thing that

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:31:12 1 you believe you could apply in disclosures to potential
12:31:16 2 policyholders?

12:31:18 3 A No, it is not.

12:31:20 4 Q Why not?

12:31:22 5 A Well, one reason is attempting to include anything
12:31:27 6 related to a process like this in a policy illustration
12:31:32 7 would violate the illustration law.

12:31:36 8 Q Would you, back in 2005 through 2011 when you were an
12:31:41 9 illustration actuary, be willing, consistent with the
12:31:44 10 relevant laws and your professional responsibilities, to
12:31:47 11 certify an illustration for purposes of distribution to
12:31:51 12 potential policyholders that included this type of
12:31:54 13 stochastic analysis in the interest rate section?

12:31:58 14 A No, I would not.

12:32:00 15 Q Do you believe you could do that?

12:32:01 16 A I do not believe I could do that.

12:32:03 17 MR. MARTENS: Just one second, Your Honor.

12:32:17 18 (Defense counsel conferring)

12:32:20 19 BY MR. MARTENS:

12:32:22 20 Q This issue that we are looking at on page 153 of
12:32:26 21 Exhibit 87, is Elizabeth MacGowan at all involved in that
12:32:32 22 process?

12:32:32 23 A No, she is not.

12:32:34 24 Q I think you said you're in the corporate actuarial
12:32:37 25 department?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:32:37 1 A That's correct.

12:32:38 2 Q And she's in product?

12:32:40 3 A That's correct.

12:32:41 4 Q Does the product group have any involvement with this
12:32:43 5 type of analysis?

12:32:45 6 A No, they do not.

12:32:47 7 MR. MARTENS: No further questions.

12:32:49 8 THE COURT: We will take our last break of the day
12:32:51 9 here, ladies and gentlemen. We will be in recess for 15
12:32:54 10 minutes. Please remember the admonition.

12:32:55 11 (Recess taken at 12:33 p.m.;

12:33:07 12 proceeding resumed at 12:47 p.m.)

12:47:15 13 THE COURT: Mr. Martens, how much more do you have
12:47:18 14 with Mr. Smith?

12:47:20 15 MR. MARTENS: I think I completed right before the
12:47:21 16 break, Your Honor. After their examination I have a few
12:47:24 17 documents I'd like to have admitted into evidence. I don't
12:47:25 18 think the jury needs to hang around for that. I don't need
12:47:25 19 to publish any of them.

12:47:25 20 THE COURT: All right.

12:47:26 21 MR. MARTENS: I would be happy to conditionally
12:47:28 22 rest after the cross of Mr. Smith.

12:47:32 23 THE COURT: Okay.

12:47:32 24 Let's bring the jury in, please.

12:47:35 25 (Jury present)

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:48:48 1 MR. FOSTER: May I approach the witness with a
12:48:49 2 binder, Your Honor?

12:48:50 3 THE COURT: You may.

12:48:50 4 MR. FOSTER: Thank you.

12:48:50 5 CROSS-EXAMINATION

12:48:51 6 BY MR. FOSTER:

12:49:09 7 Q Mr. Smith, we spoke the other day; correct?

12:49:12 8 A That's correct.

12:49:12 9 Q And do you remember that after we spoke, your counsel
12:49:15 10 did not ask you any questions? Do you remember that?

12:49:18 11 A I do remember that.

12:49:20 12 Q In the intervening days, have you had time to meet with
12:49:24 13 your counsel?

12:49:25 14 A Yes, I have.

12:49:25 15 Q And without telling me the contents of any
12:49:27 16 communications that you had with your counsel, you had the
12:49:30 17 opportunity to meet with Mr. Martens?

12:49:34 18 A Yes, I did.

12:49:35 19 Q And are there others in this room that you had the
12:49:38 20 opportunity to meet with?

12:49:39 21 A Yes, I did.

12:49:40 22 Q How many others in this room did you have the
12:49:43 23 opportunity to meet with?

12:49:45 24 A I don't recall exactly. I guess maybe one or two.

12:49:52 25 Q One or two?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:49:53 1 A Yes, in addition to Mr. Martens.

12:49:57 2 Q In addition to Mr. Martens. Okay. I want to ask you

12:50:01 3 about one aspect of your testimony.

12:50:05 4 And how long did you meet with others in this

12:50:08 5 room?

12:50:10 6 A You mean after Tuesday?

12:50:11 7 Q Yes.

12:50:14 8 A Maybe an hour at most.

12:50:18 9 Q You testified that you looked over Mr. Anderson's

12:50:23 10 analysis and you found that it was deeply flawed; correct?

12:50:30 11 A That's correct.

12:50:31 12 Q Now, when you were here the other day, didn't I ask

12:50:31 13 you, quote: Well, you don't recall ever doing anything in

12:50:34 14 response to this e-mail other than forwarding it to

12:50:38 15 Elizabeth MacGowan; correct? And you said: That's correct?

12:50:41 16 A That sounds correct.

12:50:42 17 Q You didn't tell the jury that you looked over

12:50:45 18 Mr. Anderson's analysis and found it deeply flawed; did you?

12:50:50 19 A No, I did not.

12:50:52 20 MR. MARTENS: Objection. Misstates what he just

12:50:53 21 testified to.

12:50:54 22 THE COURT: Overruled.

12:50:56 23 BY MR. FOSTER:

12:50:56 24 Q Weren't you also asked -- you said, quote: I'm fully

12:51:01 25 confident that Ms. MacGowan knows the appropriate amount of

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:51:04 1 work to devote to any specific correspondence she receives.

12:51:08 2 And I asked you: But your confidence doesn't bear
12:51:12 3 any relationship to the subject matter of this communication
12:51:14 4 because you already testified that you didn't actually look
12:51:18 5 or do any analysis of the subject matter of the
12:51:22 6 communication; did you?

12:51:23 7 Your answer was: I did no further analysis of
12:51:26 8 Mr. Anderson's letter beyond forwarding it to Ms. MacGowan.
12:51:29 9 That was your answer; correct?

12:51:32 10 A That sounds correct.

12:51:33 11 Q Okay. But you came here today and you testified that
12:51:35 12 you did do further analysis and you found that it was deeply
12:51:40 13 flawed; correct?

12:51:41 14 A That's correct.

12:51:41 15 Q So your testimony here today is directly contrary to
12:51:44 16 your testimony two days ago; correct?

12:51:46 17 A No, that is not correct.

12:51:48 18 Q Well, two days ago you testified that you did no
12:51:51 19 further analysis, and today you're here telling the jury
12:51:55 20 that you did further analysis and Mr. Anderson's letter was
12:51:59 21 deeply flawed; correct?

12:52:01 22 A That's correct.

12:52:02 23 Q And those two statements, they cannot be squared; can
12:52:06 24 they?

12:52:06 25 A They can very easily be squared.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:52:08 1 Q When you testified that you did no further analysis of
12:52:09 2 Mr. Anderson's letter the other day, do you think the jury
12:52:12 3 would understand that you were saying that you did further
12:52:14 4 analysis and found it deeply flawed?

12:52:19 5 A As of Tuesday the jury would probably have understood
12:52:24 6 me to have said that I had done no further analysis as of
12:52:27 7 that time.

12:52:28 8 Q And what you're testifying here today that as of
12:52:28 9 Tuesday that would have been misleading because you did do
12:52:34 10 further analysis?

12:52:35 11 A I'm saying no such thing.

12:52:37 12 Q Well, you testified that they would have an
12:52:38 13 understanding as of Tuesday based on your testimony, and
12:52:41 14 you're coming here today stating that that understanding
12:52:44 15 they would have gotten from your testimony under oath would
12:52:48 16 have been wrong; correct?

12:52:49 17 A I don't understand the sentence you just said, but I'll
12:52:50 18 point out that two days have elapsed between Tuesday and
12:52:57 19 today.

12:52:57 20 Q So what you're telling me is that in the two days that
12:52:59 21 have elapsed, you went back and did analysis on this letter?

12:53:05 22 A That's correct.

12:53:05 23 Q So to be clear, this letter was sent to you and at the
12:53:11 24 time you did no analysis; correct?

12:53:14 25 A That's correct.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:53:16 1 Q And you were asked about this letter at your
12:53:18 2 deposition, and that was on December 7, 2012; correct?
12:53:25 3 A I believe that's correct.
12:53:26 4 Q And you said you had done no analysis; correct?
12:53:29 5 A Correct.
12:53:30 6 Q And after that deposition you didn't go back and do any
12:53:33 7 analysis; did you?
12:53:34 8 A Not that I recall.
12:53:36 9 Q And you were asked about it two days ago, and you
12:53:38 10 didn't do any analysis prior to two days ago; correct?
12:53:42 11 A Correct.
12:53:43 12 Q And then after you testified two days ago, your counsel
12:53:47 13 didn't ask you any questions, spoke with you for an hour,
12:53:50 14 and all of a sudden you have done an analysis; correct?
12:53:53 15 A I have done an analysis in the two days between Tuesday
12:53:57 16 and today.
12:53:58 17 Q And was there any work in this analysis that you
12:54:02 18 conducted?
12:54:04 19 A Pardon me. I didn't hear the question.
12:54:04 20 Q Was there any written work that you conducted as part
12:54:07 21 of this analysis?
12:54:08 22 A Was there any what?
12:54:08 23 Q Written work.
12:54:08 24 A Written?
12:54:09 25 Q Yeah. Like, did you write anything down?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:54:15 1 A No, I did not.

12:54:15 2 Q You just looked at it and decided that you didn't think

12:54:19 3 that it was a valid criticism?

12:54:24 4 A I was able to look through what Mr. Anderson -- I was

12:54:30 5 able to look through the material in that exhibit and

12:54:34 6 determine that Mr. Anderson's analysis was badly flawed;

12:54:38 7 correct.

12:54:39 8 Q Okay. So when Mr. Anderson wrote that LSW's

12:54:43 9 illustrations bordered on deception and cheating, you

12:54:48 10 conducted no analysis; correct?

12:54:49 11 A At the time I forwarded it to Ms. MacGowan, as I

12:54:52 12 testified.

12:54:53 13 Q And when you were alerted that LSW's illustrations

12:54:56 14 verged on deception and cheating at your deposition, you

12:55:02 15 didn't think it was important to conduct any analysis then;

12:55:03 16 did you?

12:55:05 17 A I felt at the time that my action of forwarding it to

12:55:07 18 Ms. MacGowan was sufficient.

12:55:09 19 Q And two days ago you decided that your action of

12:55:12 20 forwarding it to Ms. MacGowan was not sufficient; correct?

12:55:16 21 A No, that is not correct.

12:55:17 22 Q You decided you needed to go out and do further

12:55:20 23 analysis; correct?

12:55:21 24 A I did do further analysis after that. However, my

12:55:24 25 decision to forward it to Ms. MacGowan was the correct

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:55:27 1 decision to do.

12:55:28 2 MR. FOSTER: Your Honor, I would move to strike
12:55:32 3 everything after I did further analysis.

12:55:36 4 THE COURT: Denied.

12:55:37 5 BY MR. FOSTER:

12:55:37 6 Q Do you wish at the time you got this letter that you
12:55:43 7 had done further analysis?

12:55:44 8 A No, I don't.

12:55:45 9 Q All right. Moving on. We have talked about the
12:55:51 10 certification that you signed, which was Exhibit 226. The
12:56:11 11 certification reads: Illustrated non-guaranteed elements
12:56:17 12 for new and in-force policies subject to this regulation are
12:56:22 13 consistent with the non-guaranteed elements amounts actually
12:56:26 14 credited or charged to the same or similar forms; correct?

12:56:29 15 A That is correct.

12:56:30 16 Q And you have testified that non-guaranteed elements
12:56:35 17 include this reduced monthly administrative charge; correct?

12:56:39 18 A The amount of any administrative charge that is not
12:56:40 19 guaranteed would be a non-guaranteed element; correct.

12:56:47 20 Q And you have testified that there were no same or
12:56:50 21 similar forms to the Provider or Paragon product at the time
12:56:54 22 you were making these certifications; correct?

12:56:56 23 A That is not what I testified.

12:56:58 24 Q Okay. Well, you testified you didn't do any
12:57:00 25 investigation to determine whether there were any same or

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12:57:04 1 similar forms to Provider or Paragon; correct?

12:57:06 2 A I don't recall if that is what I said.

12:57:08 3 Q Okay. Well, sitting here today can you recall or
12:57:10 4 identify any forms that would be considered the same or
12:57:14 5 similar within the meaning of this regulation?

12:57:17 6 A I believe what I said was that I did not determine
12:57:20 7 whether there were or were not similar forms to this form.

12:57:26 8 Q Did you understand my question, Mr. Smith? Sitting
12:57:28 9 here today are there any same or similar forms that you can
12:57:31 10 recall that would be considered the same or similar to
12:57:35 11 Paragon or Provider for the purposes of this certification?

12:57:40 12 A As I just said, I have never determined whether or not
12:57:44 13 there were the same or similar forms, and that statement
12:57:48 14 holds true today.

12:57:49 15 Q Thank you. But what you testified, I believe, is that
12:57:54 16 this language, when you certified it, your understanding is
12:57:59 17 that it means illustrated non-guaranteed elements for new
12:58:06 18 and in-force policies subject to this regulation are not
12:58:11 19 inconsistent with the non-guaranteed elements actually
12:58:14 20 credited or charged to the same or similar forms. That's
12:58:18 21 your understanding; correct?

12:58:22 22 A Not exactly. I would say more accurate -- I would say
12:58:30 23 that this sentence is the same thing as saying it is not the
12:58:34 24 case that there are elements that are inconsistent with
12:58:38 25 those for the same or similar forms.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

12:58:42 1 Q So you think this sentence means the same thing as if
12:58:46 2 it said not inconsistent?

12:58:56 3 A I don't believe that's what I just said.

12:58:58 4 Q Well, explain it for us, because it says that they are
12:59:04 5 consistent with the non-guaranteed elements amounts actually
12:59:08 6 credited or charged to the same or similar forms. You have
12:59:11 7 testified that you're not aware of any same or similar
12:59:14 8 forms. So testify what you think this sentence means.

12:59:17 9 A The sentence means that it is not the case that
12:59:23 10 illustrated non-guaranteed elements are inconsistent with
12:59:28 11 any of the same or similar forms.

12:59:35 12 Q So you think it would be more clear if it said it is
12:59:40 13 not the case, and instead of consistent said inconsistent?

12:59:57 14 A Well, if you put the word that after case.

01:00:09 15 Q Thank you.

01:00:10 16 A It is not the case that illustrated non-guaranteed
01:00:13 17 elements for new and in-force policies subject to this
01:00:16 18 regulation are inconsistent with the non-guaranteed elements
01:00:21 19 amounts actually credited or charged to the same or similar
01:00:28 20 forms. I believe that to be an accurate sentence.

01:00:30 21 Q Okay. You believe that to be an accurate sentence.
01:00:30 22 And you're telling me and the jury that you don't think in
01:00:34 23 the absence of this clarification that that language in this
01:00:39 24 certification implied at all the existence of same or
01:00:43 25 similar forms?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:00:49 1 A I do not believe that a -- let me start over. I'm
01:00:53 2 confident that a regulator reviewing this certification
01:00:59 3 would take the meaning as I said.

01:01:04 4 MR. FOSTER: Objection. Ask that it be stricken.

01:01:06 5 MR. MARTENS: The answer will be stricken.

01:01:08 6 BY MR. FOSTER:

01:01:09 7 Q Do you understand the question?

01:01:10 8 A Not really. It was a very complicated question.

01:01:13 9 Q All right. I'll try and simplify it just so we
01:01:13 10 understand each other. I have added some language there
01:01:15 11 based on what you said, that it is not the case that,
01:01:19 12 inconsistent. Do you see that?

01:01:21 13 A Okay.

01:01:21 14 Q So leaving that language aside, the certification as it
01:01:25 15 was actually written and filed with the California
01:01:28 16 Department of Insurance -- are you with me?

01:01:31 17 A Yes.

01:01:31 18 Q Okay. So my question is: Are you telling the jury
01:01:36 19 that you do not think that that language implies that the
01:01:40 20 same or similar forms exist?

01:01:46 21 A I'm telling the jury that the language I used does not
01:01:50 22 imply that the same or similar forms exist, that the
01:01:54 23 language I used is equivalent to what was written there.

01:01:58 24 Q Thank you.

01:01:59 25 Now, you also talked about how in the

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01:02:03 1 certification, that there were -- the certification talks
01:02:11 2 about how the regulation and ASOP-24 were developed before
01:02:20 3 equity-indexed universal life products emerged in the
01:02:31 4 marketplace. Do you remember testifying about that
01:02:35 5 language?

01:02:35 6 A Yes, I do.

01:02:36 7 Q And these prior policies, they provided a constant
01:02:42 8 fixed interest rate in the future to policyholders; correct?

01:02:46 9 A Which prior policies are you referring to?

01:02:48 10 Q Well, I'm just trying to get clarification on your
01:02:51 11 testimony. As I understood it, you testified that there
01:02:53 12 were policies predating the equity-indexed universal life
01:02:58 13 products where, if seven percent was credited, you got that
01:03:04 14 seven percent constantly each and every year.

01:03:08 15 A Policies that existed in the marketplace prior to the
01:03:14 16 illustration regulation generally were of that form, yes.

01:03:15 17 Q Okay. But equity-indexed universal life policies,
01:03:17 18 they're credited based on an index such as the S&P; correct?

01:03:23 19 A Based on how it performs, yes.

01:03:25 20 Q Based on how the S&P 500 performs. And the S&P 500,
01:03:33 21 it's historically volatile; correct?

01:03:39 22 A The S&P 500 in a given year could go up or could go
01:03:45 23 down.

01:03:46 24 Q And the sequence of returns in the S&P 500, that
01:03:48 25 matters; correct?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:03:50 1 A It does matter, yes.

01:03:52 2 Q And it matters for the value that a policyholder can
01:03:56 3 expect to any sort of product that depends on the
01:04:02 4 performance of the S&P; correct?

01:04:03 5 A It matters to the value that the policyholder will
01:04:08 6 eventually have is correct. I don't know what the
01:04:13 7 policyholder expects.

01:04:14 8 Q Well, let's take a look at this slide 110-06. Sequence
01:04:20 9 of returns does matter when fees are being deducted. Do you
01:04:26 10 see that?

01:04:27 11 MR. MARTENS: Your Honor, this is beyond the
01:04:29 12 scope.

01:04:31 13 THE COURT: Mr. Foster.

01:04:32 14 MR. FOSTER: He testified about this language, the
01:04:34 15 constant crediting, before and the change in the regulation.

01:04:42 16 THE COURT: Did he testify to that today?

01:04:43 17 MR. FOSTER: Today, yes.

01:04:44 18 MR. MARTENS: He didn't talk about this form. I
01:04:45 19 don't know why we're going into --

01:04:46 20 THE COURT: Overruled.

01:04:48 21 BY MR. FOSTER:

01:04:48 22 Q So this is accurate, right, that the sequence of
01:04:52 23 returns matters when fees are being deducted?

01:05:05 24 A It is correct that the sequence of return does matter,
01:05:08 25 yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:05:09 1 Q And the sequence of returns matters when fees are being
01:05:11 2 deducted even if you're getting the same average rate over
01:05:15 3 time; correct?

01:05:18 4 A It depends.

01:05:20 5 Q Well, in this example you get ten percent in year one
01:05:23 6 and two percent in year two in case one, and in year two you
01:05:27 7 get two percent in year one and ten percent in year two;
01:05:30 8 correct?

01:05:31 9 A In this example, that is correct.

01:05:32 10 Q So you're getting the same average return but just the
01:05:36 11 sequence is reversed; correct?

01:05:39 12 A It depends.

01:05:40 13 Q What do you mean by it depends?

01:05:43 14 A In this case it depends on how you're defining the term
01:05:48 15 average return.

01:05:52 16 Q Well, they got ten percent interest in year one,
01:05:55 17 two percent interest in year two in case one; right? In
01:05:59 18 case two they got two percent interest in year one and
01:06:04 19 ten percent interest in year two; correct?

01:06:07 20 A That's correct.

01:06:07 21 Q And these different sequences, the fact that you got
01:06:10 22 the higher interest rate in year one and the lower interest
01:06:15 23 rate in year two, that makes a difference on the returns
01:06:18 24 that a policyholder will have; correct?

01:06:20 25 A In this example that is correct.

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01:06:38 1 Q And this volatility in the S&P 500 that we were talking
01:06:41 2 about previously, that's a characteristic of the underlying
01:06:45 3 index; correct?

01:06:47 4 A The S&P 500 can go up in a given year or it could go
01:06:51 5 down in a given year.

01:06:54 6 Q And that's a characteristic of the S&P 500 index;
01:06:57 7 correct?

01:06:58 8 A I think it's fair to say that.

01:06:59 9 Q Okay. And the certifications that we have been talking
01:07:02 10 about, those go back to the 2005-2006 period. Is it fair to
01:07:10 11 say that those certifications stayed the same over the time
01:07:12 12 that you were certifying them from 2005, I believe, to 2011?

01:07:19 13 A I cannot recall any substantive differences.

01:07:23 14 Q Do you know of any substantive differences that
01:07:29 15 occurred after 2011?

01:07:31 16 A Not that I am aware of.

01:07:33 17 Q And they include the language about the ASOP number 24
01:07:37 18 not considering equity-indexed universal life products, but
01:07:42 19 isn't it true that ASOP-24 was modified in the beginning of
01:07:48 20 2007 explicitly to consider equity-indexed universal life
01:07:53 21 products?

01:07:53 22 A Actually, now that you say that, yes, I do recall that.

01:07:57 23 Q And do you recall that ASOP-24, when it was modified to
01:08:01 24 include equity-indexed products, it said that for these
01:08:06 25 indexed life insurance products, the characteristics of the

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01:08:10 1 underlying index have to be taken into account by the
01:08:14 2 actuary?

01:08:16 3 A I don't recall the exact wording, but I do recall that
01:08:19 4 the change did reflect -- did discuss indexed products.

01:08:26 5 Q And do you recall that it involved indexed products in
01:08:35 6 the sense that it now required for an indexed life insurance
01:08:40 7 product with investment assumption is sensitive to business
01:08:43 8 or economic cycles, the actuary should consider the
01:08:46 9 characteristics of the underlying index? Do you recall that
01:08:49 10 as part of ASOP-24?

01:08:52 11 A I recall language to that affect.

01:08:54 12 Q And it is true, is it not, that LSW's policy
01:09:02 13 illustrations do not consider the effect of S&P 500
01:09:06 14 volatility on policy value?

01:09:09 15 A It depends.

01:09:12 16 Q Well, the returns depicted are all constant scenarios;
01:09:16 17 correct?

01:09:19 18 A I don't know that that's always correct.

01:09:22 19 Q Okay. You have never seen a return depicted in an
01:09:25 20 illustration that's not a constant annual return; correct?

01:09:28 21 A Not that I recall.

01:09:29 22 Q Okay. And as you testified, LSW went on certifying to
01:09:35 23 the Department of Insurance that ASOP-24 did not take into
01:09:41 24 account equity-indexed products; correct?

01:09:45 25 A No, that is not correct.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:09:46 1 Q Okay. But it's fair to say that the characteristics of
01:09:52 2 the underlying index in terms of volatility and the effect
01:09:55 3 that volatility would have on policy values were not taken
01:09:59 4 into account; correct?

01:10:02 5 A I don't think that's fair to say.

01:10:05 6 Q But you have never seen them taken into account in an
01:10:10 7 illustration provided to a policyholder; correct?

01:10:15 8 A I don't understand what you mean by taken into account.

01:10:18 9 Q Well, taking into account the fact that your policy
01:10:22 10 values are going to be different if instead of getting
01:10:27 11 seven percent each and every year, that you're going to
01:10:30 12 get -- that the sequence of returns are going to vary, and
01:10:34 13 that's going to have an effect on your value or your lapse
01:10:37 14 probability. You have never seen anything like that in the
01:10:41 15 illustration; have you?

01:10:42 16 A Subsequent to the actuarial standard of practice
01:10:45 17 changing, even when the actuarial standard of practice
01:10:50 18 changed, that did not change the fact that it is against the
01:10:55 19 illustration law to illustrate something such as
01:10:58 20 zero percent one year and 14 percent the next.

01:11:02 21 MR. FOSTER: We'll get to that but I'm going to
01:11:02 22 move to strike. That's not an answer.

01:11:06 23 THE COURT: The answer will be stricken.

01:11:09 24 BY MR. FOSTER:

01:11:09 25 Q Now, do you understand my question?

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01:11:10 1 A Would you repeat the question, please.

01:11:11 2 Q Sure. You have never seen any illustration that in any

01:11:13 3 way displayed anything other than a constant interest rate;

01:11:18 4 correct?

01:11:20 5 A Not that I recall. That's correct.

01:11:22 6 Q Okay. Let's talk about Exhibit 87. You signed this;

01:11:59 7 correct? It's in your binder under 87.

01:12:08 8 A Eighty-seven is quite thick. Could you point me to --

01:12:11 9 Q 153.

01:12:12 10 A (Witness reading document) That's correct.

01:12:13 11 Q And I believe you previously testified that this form

01:12:18 12 was filed every year; correct?

01:12:20 13 A Not this form, no.

01:12:22 14 Q Well, the asset adequacy testing certification is made

01:12:28 15 every year; correct?

01:12:29 16 A Asset adequacy testing is performed every year.

01:12:31 17 Q And there is a certification signed by the appointed

01:12:35 18 actuary with each annual and quarterly financial statement

01:12:40 19 filed in each state in which the company writes

01:12:44 20 equity-indexed universal life; correct?

01:12:46 21 A That is correct.

01:12:46 22 Q Okay. And it was filed by you from 2006 to 2011 in

01:12:52 23 regards to the Provider and Paragon products; correct?

01:12:57 24 A That is a different statement.

01:12:59 25 Q Did you sign the certification pursuant to actuarial

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01:13:06 1 guideline 36 which deals with asset adequacy with each
01:13:09 2 annual and quarterly statutory financial statement filed in
01:13:09 3 each state in which the company writes equity-indexed
01:13:09 4 universal life?

01:13:10 5 A The statement regarding -- the statement filed related
01:13:10 6 to actuarial guideline 36 is not about asset adequacy.

01:13:31 7 Q Well, let's focus in on this page right here about the
01:13:36 8 asset adequacy testing. You signed this page and it was
01:13:41 9 filed along with the Provider policy in 2006; correct?

01:13:45 10 A No. It was filed in 2005.

01:13:48 11 Q Excuse me. In 2005; correct?

01:13:51 12 A Correct.

01:13:51 13 Q And there was another one when Paragon was filed? You
01:13:57 14 signed that one, too; correct?

01:13:59 15 A I don't recall.

01:14:00 16 Q Well, if you look at Exhibit 88 in your binder -- well,
01:14:13 17 page 214 first. This is a policy form filing for Paragon;
01:14:26 18 correct?

01:14:28 19 A Yes, it is.

01:14:29 20 Q And if you look at page LSW 327 -- excuse me, 325 to
01:14:40 21 326.

01:14:47 22 A Yes.

01:14:47 23 Q Do you see there's the same language about asset
01:14:51 24 adequacy testing that we see on the screen here?

01:14:59 25 A Yes, I do.

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01:15:01 1 Q And if you look at Exhibit 292, 292 is a 2009 policy
01:15:18 2 form filing with the State of California for the Provider
01:15:21 3 product; correct?

01:15:28 4 A It is for a Provider product.

01:15:33 5 Q If you look at Bates number LSW 18182 --

01:15:42 6 MR. MARTENS: Your Honor, it does seem like we're
01:15:45 7 way beyond the scope on this one. I don't think I even
01:15:48 8 talked about this.

01:15:50 9 MR. FOSTER: He talked directly about this, but I
01:15:52 10 will move it along.

01:15:54 11 THE COURT: Move it along.

01:15:54 12 BY MR. FOSTER:

01:15:55 13 Q Do you see that page that you signed, the policy form
01:15:57 14 filing in 2009 as well with the same exact language?

01:16:05 15 A Yes, I do.

01:16:06 16 Q Okay. And you were signing this in your role as the
01:16:09 17 illustration actuary for the Paragon and Provider product?

01:16:12 18 A No, I was not.

01:16:15 19 Q You were signing it in your role -- in which role at
01:16:18 20 the company?

01:16:19 21 A I was signing it in my role as appointed actuary.

01:16:23 22 Q As appointed actuary. Are you still the appointed
01:16:25 23 actuary today?

01:16:26 24 A Yes, I am.

01:16:27 25 Q Does LSW include this same language in its policy form

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01:16:34 1 filings that it does for all its equity-indexed products
01:16:39 2 with the State of California?

01:16:40 3 A Do you mean subsequent to this filing?

01:16:44 4 Q Yes, subsequent filings related to Provider and Paragon
01:16:46 5 with the State of California would include this language in
01:16:51 6 the description of asset adequacy testing; correct?

01:16:57 7 MR. MARTENS: Objection. Best evidence rule, Your
01:16:57 8 Honor. If they want to put those documents in, they should.

01:16:59 9 THE COURT: Overruled.

01:17:00 10 THE WITNESS: I don't recall.

01:17:00 11 BY MR. FOSTER:

01:17:01 12 Q You don't recall. Okay. Now, these talk about asset
01:17:03 13 adequacy testing that was conducted; correct? Well, let me
01:17:11 14 rephrase. Asset adequacy testing, just so everyone
01:17:14 15 understands, that's part of a yearly actuarial opinion that
01:17:19 16 says that the reserves and related items for a company, when
01:17:22 17 considered in light of the assets held by the company with
01:17:25 18 respect to such reserves, make adequate provision for
01:17:32 19 anticipated cash flows; correct?

01:17:34 20 A That's correct.

01:17:34 21 Q And what the purpose of this certification is, is to
01:17:36 22 figure out whether the cash flows from the assets backing
01:17:40 23 the company's reserves are adequate to pay the benefits and
01:17:45 24 expenses associated with the policies in force; correct?

01:17:49 25 A Under the provisions of the reserve law, that's

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01:17:52 1 correct.

01:17:52 2 Q Okay. And to make sure that the company has enough
01:17:55 3 reserves to pay the policyholders what they might be owed,
01:17:59 4 the valuation actuary or the actuary conducting these asset
01:18:04 5 adequacy tests, they need to run a number of future
01:18:09 6 scenarios regarding interest rates, and in the case of
01:18:12 7 equity-indexed universal life products, the S&P 500;
01:18:15 8 correct?

01:18:16 9 A Correct.

01:18:16 10 Q And the purpose of these is to determine whether the
01:18:19 11 returns of the S&P 500, the potential returns from the
01:18:24 12 S&P 500, would be sufficient to establish that the company
01:18:28 13 has adequate assets to pay what's owed to its policyholders;
01:18:32 14 correct?

01:18:34 15 A No, that is not correct.

01:18:37 16 Q Isn't it true that a purpose of asset adequacy testing
01:18:42 17 is to assess the adequacy of both the fixed income
01:18:47 18 securities backing the guarantees as well as the options
01:18:50 19 backing the equity exposure; isn't that correct?

01:18:54 20 A It is to assess the adequacy of all of the assets.
01:18:58 21 That's correct.

01:18:59 22 Q Okay. And they're assessed under a range of potential
01:19:02 23 scenarios; correct?

01:19:03 24 A Yes, that's correct.

01:19:04 25 Q And there is documents I assume that are produced by

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01:19:08 1 actuaries related to the testing done for the Paragon and
01:19:11 2 Provider products; correct?

01:19:13 3 A That's correct.

01:19:13 4 Q So before making this type of filing, those documents
01:19:17 5 you would have reviewed and received some documents
01:19:23 6 pertaining to this; correct?

01:19:25 7 A Before making which filing?

01:19:27 8 Q Well, any of these filings -- 2005, for example.

01:19:30 9 A I don't know exactly which filing you're referring to.

01:19:33 10 Q Okay. Well, the one that's up on the screen, for
01:19:35 11 example, I believe is the Provider filing. Let me just ask
01:19:42 12 you generally: In conducting these asset adequacy tests,
01:19:47 13 you receive documents about those tests and their results;
01:19:50 14 correct?

01:19:51 15 A That is correct.

01:19:52 16 Q And that's true in regards to the Provider and Paragon
01:19:56 17 products; correct?

01:19:57 18 A Provider and Paragon are two of the products included
01:20:01 19 in LSW's asset adequacy testing. That's correct.

01:20:06 20 Q Okay. And as far as you know, none of those documents
01:20:07 21 pertaining to these asset adequacy tests for Paragon and
01:20:15 22 Provider have ever been produced to the plaintiffs besides
01:20:15 23 these filings; is that correct?

01:20:19 24 MR. MARTENS: Objection, Your Honor. This is way
01:20:19 25 out of bounds.

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01:20:21 1 THE COURT: Sustained.

01:20:21 2 BY MR. FOSTER:

01:20:26 3 Q Now, you testified that the purpose of these asset --
01:20:31 4 well, let's try and give an example so we can understand it.
01:20:35 5 I'll try and simplify things here.

01:20:50 6 This is a simplified asset adequacy example. Are
01:20:55 7 you able to read that there? It's probably a little small,
01:20:59 8 but do you see where I wrote simplified asset adequacy
01:21:06 9 example?

01:21:06 10 A Yes, I do.

01:21:06 11 Q And the other day you testified that the purpose of
01:21:08 12 asset adequacy testing was to project the amount of payments
01:21:13 13 that LSW will be making to the policyholders, so I wanted to
01:21:17 14 give some examples.

01:21:19 15 MR. MARTENS: Is that a question or a statement by
01:21:22 16 Mr. Foster? Could we have the page on that.

01:21:25 17 MR. FOSTER: Yeah, certainly.

01:21:26 18 BY MR. FOSTER:

01:21:40 19 Q Do you remember testifying that asset adequacy testing,
01:21:43 20 one of the purposes is to project the amount of payments
01:21:47 21 that LSW will be making to its policyholders?

01:21:51 22 A I don't remember testifying that.

01:22:05 23 Q Do you have a copy of the certified transcript of your
01:22:07 24 testimony the other day up there?

01:22:15 25 A It looks like I do.

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01:22:19 1 MR. FOSTER: May I approach, Your Honor?

01:22:21 2 THE COURT: You may.

01:22:28 3 BY MR. FOSTER:

01:22:29 4 Q I will come up here and share with you. If we look

01:23:51 5 together at page 191 of the transcript of your testimony the

01:23:54 6 other day at lines 1 to 3, is it correct that you testified

01:24:00 7 here: One part of the projections done within asset

01:24:04 8 adequacy testing --

01:24:08 9 MR. MARTENS: Sorry. What day?

01:24:09 10 MR. FOSTER: The day that he testified. That was

01:24:10 11 April 22nd, 2014.

01:24:13 12 MR. MARTENS: Page 191?

01:24:15 13 MR. FOSTER: Yeah, at 1 to 3, the official

01:24:16 14 certified transcript.

01:24:19 15 MR. MARTENS: It begins how?

01:24:20 16 MR. FOSTER: One part of the projections.

01:24:21 17 MR. MARTENS: That's the question. Oh, the

01:24:23 18 answer. I'm sorry.

01:24:24 19 MR. FOSTER: The question begins on the previous

01:24:25 20 page at 190.

01:24:25 21 BY MR. FOSTER:

01:24:26 22 Q What I asked you was:

01:24:27 23 "Q Right. So to determine whether it has

01:24:31 24 reasonable reserves to pay Provider policyholders,

01:24:34 25 it has to determine what it might owe the Provider

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:24:38 1 policyholders, correct, or what it might cost to
01:24:41 2 cover the amounts that it owes the Provider
01:24:44 3 policyholders?

01:24:45 4 "A One part of the projections done within
01:24:51 5 asset adequacy testing would be to project the
01:24:55 6 amount of payments that LSW will be making to the
01:24:58 7 policyholders. Yes."

01:25:00 8 Did I correctly read the transcript?

01:25:03 9 A It looks like you did, yes.

01:25:05 10 Q So that quotation that's up there, project the amount
01:25:06 11 of payments that LSW will be making to the policyholders,
01:25:08 12 that accurately reflects what you testified to; correct?

01:25:14 13 MR. MARTENS: Objection, Your Honor. It's part of
01:25:16 14 it. That's not the whole statement.

01:25:18 15 THE COURT: Read the whole thing.

01:25:19 16 MR. FOSTER: One part of the projections done
01:25:19 17 within asset adequacy testing would be to project the amount
01:25:19 18 of payments that LSW will be making to the policyholders?
01:25:24 19 Yes. I think it's perfectly clear what he's testified to.

01:25:38 20 MR. MARTENS: Right. What you wrote up there
01:25:38 21 leaves out one part of.

01:25:38 22 MR. FOSTER: All right. One part on there, if the
01:25:38 23 Court thinks it's necessary.

01:25:45 24 THE COURT: Next question.

01:25:46 25 MR. FOSTER: Thank you.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:25:47 1 BY MR. FOSTER:

01:27:03 2 Q Any dispute that's what you testified to?

01:27:11 3 A That is what I testified.

01:27:13 4 Q Thank you. Now, just so we understand the type of
01:27:17 5 asset adequacy testing that was done, which was the purpose
01:27:21 6 of this demonstrative, LSW does both deterministic and
01:27:25 7 stochastic testing; correct?

01:27:26 8 A That is correct.

01:27:28 9 Q So for a deterministic scenario, for example, and we'll
01:27:34 10 simplify it and just use four years, for example. It will
01:27:38 11 run out into the future, but you could have a movement of
01:27:41 12 seven in year one, seven in year two, seven in year three,
01:27:46 13 and seven in year four; correct?

01:27:51 14 A Yes.

01:27:51 15 Q And then LSW would determine, okay, our assets are
01:27:56 16 adequate to pay the policyholders under that scenario;
01:28:01 17 correct?

01:28:04 18 A Part of the purpose would be to look at whether the
01:28:07 19 assets are adequate under that scenario. So, yes.

01:28:11 20 Q We'll just say the answer is yes, for example.

01:28:16 21 A Okay.

01:28:16 22 Q And you could have another deterministic scenario
01:28:20 23 which, let's say, for the years were five, five, five, five;
01:28:23 24 correct?

01:28:26 25 A You could.

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01:28:26 1 Q Okay. And that would be a deterministic scenario?

01:28:31 2 A That's correct.

01:28:32 3 Q Okay. Determining are the assets adequate; correct?

01:28:35 4 A Correct.

01:28:35 5 Q And you could have another deterministic scenario which

01:28:39 6 went something like two, two, two, two; correct?

01:28:43 7 A Correct.

01:28:44 8 Q Same thing. Determine are the assets adequate under

01:28:47 9 this situation. But stochastic scenarios are different;

01:28:52 10 correct?

01:28:53 11 A Correct.

01:28:53 12 Q So your testimony is that in conducting the stochastic

01:28:56 13 scenarios, LSW takes randomized sequences of the S&P 500;

01:29:02 14 correct?

01:29:03 15 A The stochastic scenarios would include randomized

01:29:07 16 sequences of the S&P, yes.

01:29:09 17 Q Okay. So you could have one stochastic sequence which

01:29:11 18 said two, five, seven, two; correct?

01:29:19 19 A That is a possible one.

01:29:23 20 Q Possible one. Could be randomly generated S&P 500

01:29:27 21 returns. You could have another stochastic scenario which

01:29:28 22 said five, seven, two, seven; correct?

01:29:37 23 A That could be, yes.

01:29:39 24 Q And LSW does random stochastic scenarios going all the

01:29:44 25 way up to the year 100; correct?

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01:29:46 1 A No, that's not correct.

01:29:46 2 Q Not to year 100. Excuse me. To a hundred scenarios;

01:29:48 3 correct?

01:29:49 4 A That is correct. We do a hundred scenarios.

01:29:51 5 Q Okay. And you testified that you felt that these were

01:29:55 6 different from Monte Carlos because they weren't projecting

01:29:59 7 what the market would return; correct?

01:30:03 8 A I don't recall saying that.

01:30:05 9 Q Okay. But your testimony was that LSW is just taking

01:30:10 10 random scenarios of the S&P 500 and it's not projecting what

01:30:14 11 the S&P 500 may look like in the future; correct?

01:30:20 12 A We use random scenarios within our cash flow testing.

01:30:25 13 Q And those random scenarios, those return different

01:30:29 14 results than the stochastic scenarios; correct?

01:30:32 15 A Random scenarios are the same thing as stochastic

01:30:36 16 scenarios.

01:30:37 17 Q Excuse me. They return different results than the

01:30:40 18 deterministic scenarios; correct?

01:30:43 19 A That is correct.

01:30:43 20 Q And you testified, I believe, that they were different

01:30:46 21 than Monte Carlos because there isn't a probability result;

01:30:49 22 correct?

01:30:51 23 A What I testified is I don't personally view what we do

01:30:55 24 within the stochastic modeling as being a Monte Carlo

01:31:01 25 projection.

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01:31:02 1 Q Okay. So, for example, if all of these -- you know,
01:31:05 2 say the assets are adequate, you're not coming up with a
01:31:13 3 probability that the assets will be adequate; correct?

01:31:17 4 A Correct.

01:31:17 5 Q Okay. But you understand that instead of just taking
01:31:22 6 randomized movements in the S&P 500, you could project based
01:31:28 7 on historical sequences of the S&P 500; correct?

01:31:33 8 A Within the projection I can use any sequence of the S&P
01:31:38 9 500 as I like.

01:31:39 10 Q And one of the sequences that you could use if you so
01:31:43 11 chose was the historical sequence of the S&P 500; correct?

01:31:47 12 A I could have, yes.

01:31:48 13 Q And that wouldn't have caused you any problems or any
01:31:52 14 difficulty; correct?

01:31:53 15 A Using that sequence within my asset adequacy analysis
01:32:02 16 would be fine.

01:32:03 17 Q Okay. And it would have been fine back in 2005 when
01:32:07 18 these products were introduced?

01:32:08 19 A That's correct.

01:32:09 20 Q It would have been fine even going back prior to before
01:32:10 21 2005 when the products were introduced?

01:32:15 22 A I would have had no need to before the products were
01:32:18 23 introduced.

01:32:20 24 Q But you don't have any doubt that it could have been
01:32:22 25 done?

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01:32:23 1 A Correct.

01:32:23 2 Q Okay. So, for example, putting up 116-01, you see at

01:32:54 3 the top there is a sequence of S&P 500 returns going by

01:32:58 4 year? The top bar, year return, and then there's each year

01:33:05 5 after application of the cap and floor there is a

01:33:09 6 percentage?

01:33:10 7 A Which row?

01:33:11 8 Q The top row.

01:33:12 9 A You mean the row that says after cap and floor?

01:33:16 10 Q Yeah, exactly.

01:33:16 11 A Okay. I see that.

01:33:20 12 Q And that has the returns by year after application of

01:33:23 13 the cap and floor. At least that's what the document

01:33:27 14 purports to say. And those sequences of S&P 500 returns,

01:33:31 15 those could be randomly rearranged, correct, to have a

01:33:35 16 different order?

01:33:37 17 A I guess so, yes.

01:33:39 18 Q If they were randomly rearranged in a different order

01:33:42 19 and each variation, if there were fees coming out, the

01:33:47 20 result would be different for a policyholder who put money

01:33:51 21 into a policy; correct?

01:33:52 22 A Yes, that would be correct.

01:33:54 23 Q And you knew that back in 2005; correct?

01:33:58 24 A Yes.

01:34:00 25 Q And others at the company know that, too; correct?

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01:34:03 1 A I think that's fair to say, yes.

01:34:16 2 Q Now, you gave an opinion about violating the
01:34:19 3 illustration regulation. I want to try and understand that
01:34:29 4 opinion.

01:34:29 5 A Okay.

01:34:30 6 Q So are you expressing the opinion that interest rates
01:34:36 7 higher than the disciplined current scale cannot be shown in
01:34:41 8 an illustration?

01:34:42 9 A Correct.

01:34:49 10 Q So, for example, if you had something like this which
01:34:58 11 was previously marked as 2001 for identification purposes,
01:35:02 12 and there was a sequence which -- you see there's a weighted
01:35:07 13 average interest rate there?

01:35:08 14 A Yes.

01:35:09 15 Q And it says, you know, it's in the range of 9.6 percent
01:35:13 16 or so?

01:35:14 17 A Okay.

01:35:14 18 Q And there is some numbers that were written next to it
01:35:18 19 that say 11, 13. Do you see those?

01:35:22 20 A Yes.

01:35:23 21 Q There is absolutely no dispute that those numbers could
01:35:25 22 not be shown in the current basis B column of the
01:35:28 23 illustration; correct?

01:35:29 24 A If the disciplined current scale is 9.5 or 9.6 or
01:35:36 25 whatever, one cannot show 11 or 13. That's correct.

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01:35:41 1 Q Right. And the weighted average interest rate, that's
01:35:43 2 based on the disciplined current scale in the illustration;
01:35:46 3 correct?

01:35:47 4 A The disciplined current scale would be part of where
01:35:52 5 that number comes from; correct.

01:35:53 6 Q So your opinion is that you can't show these numbers
01:35:58 7 that are higher than the weighted average interest rate
01:36:02 8 because they would be higher than the disciplined current
01:36:06 9 scale; correct?

01:36:07 10 A Correct.

01:36:08 11 Q What regulation do you rely on for that?

01:36:11 12 A Both the NAIC model insurance regulation and the
01:36:19 13 California illustration law.

01:36:20 14 Q Okay. So let's talk about the California illustration
01:36:22 15 law. If you look at Exhibit 606 in your binder.

01:36:41 16 A Okay.

01:36:44 17 Q If you look at section 10509.956(a)(7), which is at
01:36:54 18 page 5 of 11.

01:37:06 19 A Okay.

01:37:07 20 Q Now, is that the language that you were referring to as
01:37:11 21 the basis for your opinion that you can't show interest
01:37:15 22 rates higher than a disciplined current scale?

01:37:18 23 A In part.

01:37:19 24 Q Okay. That's the part of the California law that
01:37:21 25 pertains to your opinion?

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01:37:23 1 A This is part of the California law.

01:37:24 2 Q Okay. And this is the section of the California law
01:37:26 3 that pertains to your opinion that you can't show interest
01:37:30 4 rates higher than the disciplined current scale; correct?

01:37:38 5 A In addition to this section, there is another section.

01:37:42 6 Q On page 4?

01:37:43 7 A Correct.

01:37:44 8 Q And it says pretty much the same thing at sub-five.

01:37:49 9 You can't use an illustration at a policy duration that is
01:37:52 10 depicting policy performance more favorable to the policy
01:37:57 11 owner than that produced by the illustrated scale of the
01:37:58 12 insurer whose policy is being illustrated; right?

01:38:02 13 A Correct.

01:38:02 14 Q So those are the two sections of the California
01:38:06 15 regulation that you're referring to; correct?

01:38:07 16 A With regard to by year, yes.

01:38:12 17 Q Now, setting that aside -- and the reason you couldn't
01:38:18 18 show 13 percent when the disciplined current scale returned
01:38:23 19 nine percent is that that would be showing a policyholder
01:38:25 20 getting a numeric value that was higher than the disciplined
01:38:30 21 current scale would support; correct?

01:38:34 22 A It would be a return higher than the scale, yes.

01:38:36 23 Q Okay. It would be a return higher than the scale.
01:38:36 24 Now, the regulation, though, it doesn't speak to telling
01:38:40 25 consumers about a risk of lapse, does it, in these two

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01:38:49 1 sections about the disciplined current scale?

01:38:53 2 A Not in those two sections.

01:38:55 3 Q Okay. Well, telling a consumer about a risk of lapse
01:39:01 4 based on volatility in the S&P 500, that doesn't require you
01:39:05 5 to show any illustrated scale to the policyholder; does it?

01:39:15 6 A Do you mean just making a verbal statement?

01:39:18 7 Q Or making a written statement in the illustration.

01:39:22 8 A I suppose one can make a written statement without
01:39:25 9 showing numbers.

01:39:26 10 Q Okay. And if there was a written statement, that would
01:39:29 11 not in your opinion violate these provisions of the
01:39:33 12 California regulation?

01:39:36 13 A The entire regulation is much longer than that, and I
01:39:40 14 would want to review the entire regulation.

01:39:42 15 Q Well, let me ask you specifically: If there was a
01:39:46 16 disclosure, a written disclosure in the illustration that
01:39:48 17 the values shown in current basis B assume a constant rate
01:39:53 18 of return for the indexed strategy but actual returns to the
01:39:57 19 S&P 500 will be volatile but not constant, the current basis
01:40:01 20 B values may understate the risks of lapse due to volatility
01:40:06 21 even if the S&P 500 performs in the future at the same rate
01:40:10 22 on average as is used in calculating the current basis B
01:40:14 23 values. Can you think of any reason why that disclosure, if
01:40:18 24 true, could not be given?

01:40:23 25 A Not that I can think of.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:40:26 1 Q So that one dealt with lapse. Let me ask you about a
01:40:32 2 disclosure about reduced value. If there was a written
01:40:35 3 disclosure, the values shown in current basis B assume a
01:40:38 4 constant rate of return for the indexed strategies but
01:40:41 5 actual returns to the S&P 500 will be volatile and not
01:40:44 6 constant, the current basis B values may be overstated even
01:40:47 7 if the S&P 500 performs in the future at the same rate on
01:40:52 8 average as is used in calculating the current basis B
01:40:57 9 values. Is there anything that you can think of that would
01:41:00 10 stop LSW from giving that disclosure, if true?

01:41:03 11 A If true, not that I can think of.

01:41:05 12 Q Nothing would stop them from giving either of those
01:41:07 13 disclosures in their illustrations; would it?

01:41:10 14 A Not that I can think of.

01:41:11 15 Q Okay. Let's talk about a statistic. So if a
01:41:23 16 policyholder was informed that even if the S&P 500 performs
01:41:28 17 on average in the future as is depicted in your current
01:41:33 18 basis B illustration, you have a 64 percent chance of lapse
01:41:37 19 based on that illustration before your life expectancy.
01:41:40 20 There is nothing in the regulations that would prohibit
01:41:44 21 giving them that statistic; is there?

01:41:47 22 A I don't know.

01:41:48 23 Q You are not aware of anything that would prohibit LSW
01:41:51 24 from disclosing to policyholders a lapse risk statistic
01:41:55 25 about the likelihood that their policy could lapse before

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01:41:58 1 their life expectancy?

01:42:01 2 A I would be concerned about such a disclosure without
01:42:06 3 doing further research.

01:42:07 4 Q Sure. But if true, there is nothing in any of the
01:42:10 5 regulations that you're aware of that would prohibit LSW
01:42:14 6 from giving that disclosure?

01:42:16 7 A My concern is the statement there is a 64 percent
01:42:20 8 probability or whatever it was. There is no way of
01:42:24 9 assigning a truth to a probability like that.

01:42:27 10 Q Right. So you're saying that there would need to be
01:42:30 11 additional disclosures about the method for calculating that
01:42:35 12 statistic and disclaimers that actual results may be more or
01:42:40 13 less favorable, things like that?

01:42:42 14 A I'm saying I'm not aware of any way to accurately
01:42:48 15 calculate that statistic.

01:42:51 16 Q Well, respectfully, that wasn't my question. I'm
01:42:53 17 assuming, saying that it could be calculated and saying that
01:42:58 18 it was true for an individual policyholder they had a
01:43:01 19 64 percent chance of lapsing before their life expectancy
01:43:05 20 based on the returns depicted in the illustration, is there
01:43:09 21 anything in the two sections of the California regulation
01:43:13 22 that we discussed that would prohibit LSW from giving that
01:43:17 23 information?

01:43:21 24 A So the preface to the question is saying something I
01:43:27 25 think is impossible to calculate can be calculated, so

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:43:31 1 assuming the impossible?

01:43:34 2 MR. FOSTER: Move to strike, Your Honor.

01:43:36 3 THE COURT: It will be stricken.

01:43:37 4 BY MR. FOSTER:

01:43:37 5 Q I'm asking you to assume it can be calculated, and
01:43:39 6 assuming the number is true. We have talked about two
01:43:41 7 sections of the illustration, the California regulation, and
01:43:45 8 there is nothing in either of those two sections that would
01:43:48 9 prohibit giving a consumer a statistic that they had a
01:43:53 10 64 percent of chance of lapse before their life expectancy;
01:43:56 11 correct?

01:43:59 12 A Given all of the assumptions that you just stated,
01:44:04 13 within those two narrow sections of the law, I believe
01:44:07 14 that's correct.

01:44:09 15 Q Moving on. Beyond those two narrow sections, you're
01:44:13 16 not aware of anything else in California law that would
01:44:16 17 prohibit giving that statistic, like a 64 percent statistic;
01:44:20 18 are you?

01:44:25 19 A I would want to review an awful lot of law before
01:44:29 20 reaching a conclusion like that. But off the top of my
01:44:33 21 head, no, I'm not aware of any.

01:44:35 22 Q And that's true not only in regards to the California
01:44:38 23 regulation but to all -- that's fine.

01:44:43 24 Is it also true that -- we talked about an
01:44:46 25 individual statistic for an individualized policyholder. In

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:44:50 1 regards to statistics for groups of policyholders as a
01:44:55 2 whole, if it was true that there was a 90 or 95 percent
01:45:01 3 chance of reduced value for these policies even if the S&P
01:45:05 4 500 performed on average in the future as the rate depicted
01:45:10 5 in the current basis B illustration over time, is there
01:45:13 6 anything in the California illustration regulation that
01:45:18 7 would prohibit LSW from giving that information to
01:45:21 8 consumers?

01:45:25 9 A I don't believe there is anything in the regulation
01:45:26 10 that talks about groups of policies at all.

01:45:29 11 Q And there is nothing in giving that statistic to
01:45:32 12 consumers that would violate the regulation that you can
01:45:35 13 think of?

01:45:42 14 A With the same caveats I provided in the last answer,
01:45:46 15 that's correct. I can think of nothing off the top of my
01:45:50 16 head.

01:45:50 17 Q Right. And going beyond California and assuming these
01:45:53 18 statistics can be calculated and are true and correct, there
01:45:57 19 is nothing you can think of that would prohibit LSW from
01:46:00 20 giving these disclosures; correct?

01:46:02 21 A Again with all the caveats and assumptions in my prior
01:46:05 22 answer, I would have the same answer.

01:46:07 23 Q Okay. There is nothing that would prohibit them from
01:46:09 24 giving those in the illustration itself; correct?

01:46:15 25 A Not that I am aware of.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:46:16 1 Q And there's nothing that would prohibit it in giving it
01:46:19 2 in a supplemental optional report that it required to come
01:46:19 3 along with the illustration; correct?

01:46:26 4 MR. MARTENS: What is the reference to "it?"

01:46:27 5 BY MR. FOSTER:

01:46:27 6 Q There's nothing that would prohibit giving the types of
01:46:30 7 statistics that we're discussing, whether for an individual,
01:46:32 8 their individualized chance of lapsing before life
01:46:32 9 expectancy or for a group the reduced expected value for all
01:46:32 10 policyholders as a whole, there would be nothing to prohibit
01:46:32 11 LSW from giving that information in a supplemental optional
01:46:47 12 report that it required to be provided with the
01:46:50 13 illustration; is there?

01:46:51 14 A Again within the hypothetical assumption of something I
01:46:54 15 don't believe is possible, I'm not aware of anything that
01:46:57 16 would prohibit it.

01:47:01 17 MR. FOSTER: I'd move to strike the possible part,
01:47:03 18 Your Honor.

01:47:04 19 THE COURT: It will be stricken.

01:47:05 20 MR. FOSTER: Thank you.

01:47:05 21 BY MR. FOSTER:

01:47:05 22 Q There is nothing you are aware of that would prohibit
01:47:12 23 it; correct?

01:47:12 24 A Correct.

01:47:14 25 Q Nothing at all?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:47:15 1 A Correct.

01:47:26 2 MR. FOSTER: I have nothing further, Your Honor.

01:47:27 3 THE COURT: Mr. Martens.

01:47:28 4 REDIRECT EXAMINATION

01:47:29 5 BY MR. MARTENS:

01:48:01 6 Q Just going back briefly to Mr. Foster's hypotheticals
01:48:05 7 to you, would your answer be different if those statistics
01:48:09 8 were calculated based on an assumption that in certain years
01:48:13 9 the interest rate was above the disciplined current scale?

01:48:24 10 A I guess I don't understand the question.

01:48:28 11 Q Are you familiar on illustrations, going back -- let's
01:48:33 12 take Exhibit 2001. Do you see there is an interest rate
01:48:39 13 column in current basis B on page 11 of 21?

01:48:43 14 A Yes.

01:48:43 15 Q And then there is a cash surrender value. Do you see
01:48:47 16 that?

01:48:47 17 A Yes, I do.

01:48:48 18 Q Do you believe that you could as an illustration
01:48:52 19 actuary certify an illustration that contained interest
01:48:55 20 rates above the disciplined current scale?

01:48:58 21 A No, I do not.

01:48:59 22 Q Even if it was only one year above the disciplined
01:49:02 23 current scale?

01:49:03 24 A Correct.

01:49:03 25 Q You couldn't do that?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:49:05 1 A The law does not allow it for any year.

01:49:08 2 Q As you understand it?

01:49:10 3 A As I understand it.

01:49:10 4 Q And the cash surrender value, could you report a cash

01:49:14 5 surrender value that was calculated based on an interest

01:49:18 6 rate for any given year that was above the disciplined

01:49:22 7 current scale?

01:49:23 8 A No, I could not.

01:49:24 9 Q That's what you believe as you understand the law?

01:49:26 10 A That's correct.

01:49:26 11 Q Could you report any other statistic or figure that was

01:49:30 12 based on an interest rate that in any given year was above

01:49:35 13 the disciplined current scale?

01:49:36 14 A No, I could not.

01:49:37 15 Q So if the percentages of lapse probability in

01:49:40 16 Mr. Foster's hypothetical were calculated based on Monte

01:49:45 17 Carlos that included interest rates in a given year above

01:49:48 18 the disciplined current scale, would that impact your answer

01:49:53 19 on whether or not you could report those lapse

01:49:55 20 probabilities?

01:49:56 21 A Yes, it would.

01:49:57 22 Q If those Monte Carlo statistics of lapse probability

01:50:00 23 were based on interest rates that in any given year were

01:50:05 24 above and below the disciplined current scale, do you

01:50:10 25 believe consistent with law you could report those lapse

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:50:13 1 figures?

01:50:14 2 A No, I do not.

01:50:15 3 THE COURT: Wait a minute. I think the last
01:50:15 4 answer is ambiguous.

01:50:15 5 BY MR. MARTENS:

01:50:18 6 Q When you say no, you do not, meaning no, you do not
01:50:21 7 believe that you could report that?

01:50:23 8 A I do not believe I could report a number that was based
01:50:29 9 in any way on any year being higher than the disciplined
01:50:36 10 current scale.

01:50:38 11 Q Just to be clear, looking at those two subsections of
01:50:42 12 the law that Mr. Foster showed you and applying your
01:50:46 13 understanding of that law and your professional judgment,
01:50:48 14 could you report the results of a Monte Carlo that included
01:50:53 15 years with interest rates above the disciplined current
01:50:59 16 scale?

01:51:00 17 A No, I could not.

01:51:00 18 Q So if the Monte Carlos results were calculated --
01:51:05 19 excuse me. If the Monte Carlos were run with years above
01:51:07 20 the disciplined current scale to generate lapse percentages,
01:51:12 21 do you believe consistent with the law you could report
01:51:15 22 those lapse percentages?

01:51:17 23 A Consistent with the law I do not believe I could report
01:51:21 24 those lapse percentages.

01:51:23 25 Q And as an illustration actuary, consistent with your

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01:51:24 1 professional obligations, would you certify an illustration
01:51:26 2 that contained lapse statistics that were calculated in that
01:51:29 3 manner?

01:51:29 4 A No, I would not.

01:51:32 5 Q Are you aware of any illustration actuary who has ever
01:51:36 6 done that?

01:51:36 7 A No, I am not.

01:51:43 8 Q Now, you were also asked some questions about your
01:51:46 9 illustration actuary certifications in subsequent years. Do
01:51:49 10 you recall that?

01:51:50 11 A Yes, I do.

01:51:52 12 Q When I was examining you, I showed you, I believe it
01:51:54 13 was, Exhibit 87, which was your 2005 certification for one
01:51:59 14 of the policies?

01:52:10 15 A Now I'm losing you. Exhibit 87?

01:52:17 16 Q I'm sorry. It's 226.

01:52:19 17 A Okay. Yes, 226 I have.

01:52:23 18 Q I apologize for that. You were asked about the
01:52:29 19 certification about compliance with ASOP-24 by Mr. Foster.
01:52:34 20 Do you recall that?

01:52:35 21 A Yes, I do.

01:52:36 22 Q And he asked you whether or not after Exhibit 226 in
01:52:40 23 2005 you continued certifying the same thing in subsequent
01:52:47 24 years. Do you recall that?

01:52:48 25 A Yes, I do.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:52:48 1 Q But he didn't actually show you the subsequent years;
01:52:51 2 correct?

01:52:52 3 A That's correct.

01:52:52 4 Q And then he brought up, oh, but the regulation changed.
01:52:57 5 Do you remember that?

01:52:57 6 A Yes, I do.

01:52:58 7 Q And he still didn't show you the form. Do you remember
01:53:01 8 that?

01:53:01 9 A Yes, I do.

01:53:02 10 Q So I'm going to show it to you.

01:53:04 11 MR. MARTENS: Exhibit 251, pages 7 to 9, which I
01:53:11 12 would like to mark as Exhibit 251-A, Your Honor.

01:53:14 13 THE COURT: You may.

01:53:18 14 MR. MARTENS: And before I publish it, because I'm
01:53:18 15 not sure it's in evidence, can I show it to the witness to
01:53:23 16 make sure he can identify it?

01:53:26 17 THE COURT: Please.

01:53:26 18 MR. MARTENS: Thank you.

01:53:26 19 BY MR. MARTENS:

01:53:36 20 Q Do you recognize Exhibit 251-A as a certification that
01:53:40 21 you made in subsequent years for, among other policies, the
01:53:47 22 Provider policy?

01:53:48 23 A Could I look at it again quickly?

01:53:50 24 Yes, I do.

01:53:51 25 Q In fact, just so the jury can see what we're looking at

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:53:55 1 here --

01:54:03 2 THE COURT: Do you want to offer it?

01:54:04 3 MR. MARTENS: I would like to offer Exhibit 251-A
01:54:09 4 in evidence, Your Honor.

01:54:11 5 MR. FOSTER: I don't have a copy, Your Honor, but
01:54:11 6 no objection.

01:54:15 7 THE COURT: 251-A will be received.

01:54:16 8 (Exhibit No. 251-A received in evidence)

01:54:16 9 BY MR. MARTENS:

01:54:17 10 Q Do you recognize this as the illustration actuary
01:54:21 11 certification made on October 6, 2009?

01:54:25 12 A Yes, I do.

01:54:25 13 Q And it lists a number of policies that it's made for;
01:54:28 14 is that correct?

01:54:28 15 A That's correct.

01:54:28 16 Q And one of them is illustration policy form 8212. Do
01:54:32 17 you see that?

01:54:33 18 A Yes, I do.

01:54:33 19 Q And going back to Exhibit 226, that's the same policy
01:54:40 20 form number as Provider; correct?

01:54:42 21 A Yes.

01:54:42 22 Q And there is language about ASOP-24. Do you see that
01:54:50 23 on Exhibit 251-A?

01:54:53 24 A Yes, I do.

01:54:53 25 Q So just to make sure we're clear here, there was

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01:54:56 1 language before the regulation that was changed in

01:54:59 2 Exhibit 226; correct?

01:55:01 3 A Correct.

01:55:02 4 Q And it talks about whether it's possible to do it
01:55:07 5 consistent with the prior regulation. Do you see that?

01:55:10 6 A Yes, I do.

01:55:10 7 Q And then going to Exhibit 251-A, did you change your
01:55:16 8 certification with regard to ASOP-24 to comply with the
01:55:21 9 change in the ASOP-24?

01:55:23 10 A Yes, I did.

01:55:24 11 Q Can you read for the jury what you did to change your
01:55:26 12 certification to comply with the law after the regulation
01:55:30 13 changed.

01:55:30 14 A I wrote: Consistent with the guidance provided under
01:55:33 15 ASOP-24, the interest crediting rate used in the
01:55:37 16 illustration is based on a geometric average that would have
01:55:40 17 resulted from application of a given participation rate and
01:55:44 18 cap rate to historical S&P 500 returns.

01:55:48 19 Q Why is that different language in there?

01:55:51 20 A Because as I have had my memory refreshed, in 2007
01:55:56 21 ASOP-24 was revised to explicitly provide for using this
01:56:06 22 methodology.

01:56:10 23 Q And did you then revise the language of the
01:56:12 24 certification you made in order to comply with the new
01:56:14 25 regulation?

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01:56:15 1 A I revised the language subsequent to the change in ASOP
01:56:20 2 24 going forward, yes.

01:56:22 3 Q Thank you.

01:56:24 4 Now, Mr. Foster showed you a copy of Exhibit 226
01:56:29 5 that he wrote on. I'm going to mark it 226-A so that we can
01:56:35 6 identify it. Do you remember this exhibit?

01:56:36 7 A Yes, I do.

01:56:37 8 MR. MARTENS: Your Honor, I am going to offer
01:56:42 9 Exhibit 226-A into evidence if I could.

01:56:48 10 MR. FOSTER: No objection, Your Honor.

01:56:49 11 THE COURT: It will be received.

01:56:50 12 (Exhibit No. 226-A received in evidence)

01:56:50 13 BY MR. MARTENS:

01:56:51 14 Q Do you see how Mr. Foster -- do you recall how
01:56:52 15 Mr. Foster preferred to rewrite the last sentence with a
01:56:55 16 double negative to say: It is not the case that illustrated
01:56:55 17 non-guaranteed elements for new and in-force policies
01:56:55 18 subject to this regulation are inconsistent with the
01:57:02 19 non-guaranteed elements actually credited or charged to the
01:57:06 20 same or similar forms. Do you see that?

01:57:08 21 MR. FOSTER: Objection. Misstates the record.

01:57:11 22 THE WITNESS: I do see it.

01:57:12 23 BY MR. MARTENS:

01:57:12 24 Q And that has a double negative in it; correct?

01:57:16 25 A Yes.

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01:57:17 1 Q It's not inconsistent; correct?

01:57:19 2 A Yes.

01:57:20 3 Q And you wrote "are consistent"; correct?

01:57:22 4 A The original file, in 226, yes, I did.

01:57:23 5 Q And where did you get your language? Did you get it

01:57:25 6 from Mr. Foster?

01:57:27 7 A No, I did not.

01:57:28 8 Q Where did you get the language that you used?

01:57:30 9 A I got it from a life practice note that I obtained from

01:57:34 10 the American Academy of Actuaries.

01:57:38 11 Q And did you use it word for word out of that practice

01:57:41 12 note?

01:57:41 13 A Yes, I did.

01:57:41 14 Q Now, I think that Mr. Foster moved to strike your

01:57:45 15 explanation as to how a reasonable regulator would

01:57:48 16 understand this language. Do you recall that?

01:57:50 17 A Yes, I do.

01:57:52 18 Q Could you tell us how, based on your experience, how a

01:57:54 19 reasonable regulator familiar with the regulations would

01:57:58 20 understand your language.

01:58:00 21 MR. FOSTER: Objection. Foundation.

01:58:02 22 THE COURT: Overruled.

01:58:03 23 THE WITNESS: Yes. A reasonable regulator would

01:58:05 24 know that a part of the regulation says it must be disclosed

01:58:14 25 if the non-guaranteed values are not consistent and

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01:58:22 1 therefore would take the way I wrote the -- the sentence I
01:58:27 2 wrote in the certification as indicating that there is
01:58:33 3 nothing to disclose in that regard.

01:58:35 4 BY MR. MARTENS:

01:58:37 5 Q In your experience would a reasonable regulator
01:58:40 6 understand, for example, the ASOP practice notes?

01:58:44 7 A It depends.

01:58:46 8 Q And in your experience -- well, let me ask you this:
01:58:47 9 Did DOI ever follow up and ask for any clarification?

01:58:54 10 A No, they did not.

01:58:55 11 Q And Mr. Foster asked: Well, couldn't your sentence be
01:59:00 12 read as suggesting that there are similar forms?

01:59:03 13 Do you remember him asking you that?

01:59:04 14 A I do.

01:59:05 15 Q Does California have copies of all your forms?

01:59:08 16 A Yes, they do.

01:59:08 17 Q When you filed this certification in 2005, California
01:59:14 18 had all your forms?

01:59:15 19 A That's correct.

01:59:16 20 Q For every other product you had ever offered in
01:59:18 21 California?

01:59:19 22 A That's correct.

01:59:20 23 Q So they would know whether any form was similar;
01:59:22 24 correct?

01:59:24 25 A They would have the ability to ascertain that, yes.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

01:59:27 1 Q Did you think you were sneaking anything by them here?

01:59:30 2 A No, I did not.

01:59:31 3 Q Looking at this even with Mr. Foster's rewrite, do you
01:59:34 4 have any concern that your statement was in any way
01:59:37 5 misleading?

01:59:38 6 A I have no concern whatsoever.

01:59:40 7 Q Did you have any intent to be misleading?

01:59:42 8 A No, I did not.

01:59:43 9 Q Has the California Department of Insurance ever
01:59:45 10 followed up and suggested you were misleading?

01:59:49 11 A No, they have not.

01:59:49 12 Q Have they followed up and asked you any questions about
01:59:53 13 this?

01:59:53 14 A No, they have not.

01:59:54 15 MR. MARTENS: One last thing, Your Honor. I'm
01:59:58 16 going to mark the simplified asset adequacy example. If
02:00:05 17 it's okay with Mr. Foster, I'm going to mark it Exhibit 1010
02:00:13 18 for identification.

02:00:14 19 MR. FOSTER: No objection.

02:00:14 20 BY MR. MARTENS:

02:00:15 21 Q Do you remember this exhibit that Mr. Foster showed
02:00:18 22 you?

02:00:18 23 A Yes, I do.

02:00:18 24 Q And do you see there is a section where he does the
02:00:21 25 stochastic analysis?

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02:00:21 1 A Yes, I do.

02:00:21 2 Q Do you consider that a Monte Carlo?

02:00:26 3 A No, I do not.

02:00:27 4 Q Is it designed as performed at the company to predict
02:00:29 5 probabilities that assets would be adequate?

02:00:33 6 A No, it is not.

02:00:33 7 Q And you heard questions about projections of lapse
02:00:37 8 probabilities or lapse propensity from Mr. Foster; correct?

02:00:40 9 A Correct.

02:00:41 10 Q And do you understand projections of propensity of
02:00:45 11 probability to be different than what you were doing here?

02:00:48 12 A Yes, I do.

02:00:51 13 THE COURT: How much more do you have?

02:00:52 14 MR. MARTENS: I think that's all I have got, Your
02:00:54 15 Honor.

02:00:54 16 THE COURT: Mr. Foster, how much do you have?

02:00:58 17 MR. FOSTER: I have a few minutes, Your Honor.

02:00:59 18 THE COURT: How much do you have? Give me an
02:01:01 19 estimate.

02:01:03 20 MR. FOSTER: Five to ten minutes.

02:01:05 21 THE COURT: Ladies and gentlemen, we would like to
02:01:07 22 conclude the evidence today. Is it convenient to spend
02:01:11 23 another five to ten minutes?

02:01:13 24 Okay.

02:01:13 25 MR. FOSTER: Thank you, Your Honor.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:01:13 1

RECROSS-EXAMINATION

02:01:13 2

BY MR. FOSTER:

02:01:35 3

Q Mr. Martens examined you about a later certification
that you provided; correct?

02:01:39 4

02:01:40 5

A Correct.

02:01:41 6

Q And he marked that certification, I believe, as 251-A;
correct?

02:01:47 7

02:01:50 8

A I don't recall.

02:01:52 9

Q Well, earlier when I was examining you, I asked you --
I showed you a certification and I asked you if the
certification had stayed the same. Do you remember that?

02:01:56 10

02:01:59 11

02:02:03 12

A I do remember.

02:02:05 13

Q And you said you didn't recall any changes to the
certification; correct?

02:02:08 14

02:02:08 15

A I did say that.

02:02:09 16

Q Okay. And then we went on to talk about the change in
the ASOP, and the change that I asked you about was whether
the revised ASOP said that you had to consider a
characteristic of the underlying index. Do you remember
that line of questioning?

02:02:12 17

02:02:16 18

02:02:21 19

02:02:24 20

A I remember the line of questioning.

02:02:25 21

02:02:27 22

Q Okay. And do you remember the line of questioning that
a characteristic of the underlying index, the S&P 500 index,
is volatility? Do you remember that?

02:02:30 23

02:02:34 24

A I do.

02:02:36 25

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02:02:36 1 Q And you testified that that was a characteristic of the
02:02:38 2 underlying index, volatility?

02:02:40 3 A Yes.

02:02:40 4 Q Okay. So looking at this exhibit that Mr. Martens has
02:02:45 5 marked, it is true that the language in this later one did
02:02:50 6 change; correct?

02:02:52 7 A That is correct.

02:02:53 8 Q So when you testified you didn't recall any changes,
02:02:56 9 you weren't recalling this change?

02:02:59 10 A I was not recalling this change. That's correct.

02:03:01 11 Q That's fair. That's understandable.

02:03:03 12 Now, the question I have here is you say
02:03:08 13 consistent with the guidance provided under ASOP-24, the
02:03:12 14 interest crediting rate used in the illustration is based on
02:03:14 15 a geometric average that would have resulted from
02:03:17 16 application of a given participation rate and cap rate to
02:03:20 17 historical S&P 500 returns. Do you see that?

02:03:22 18 A Yes, I do.

02:03:23 19 Q And that geometric average that is created, that's a
02:03:29 20 number, a percentage based on the historical return of the
02:03:33 21 S&P 500 filtered through the policy's caps and floors;
02:03:37 22 correct?

02:03:37 23 A That is correct.

02:03:38 24 Q And that percentage is then used in LSW's illustrations
02:03:42 25 on a constant basis each and every year; correct?

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:03:46 1 A That's correct.

02:03:46 2 Q So this certification, just like the ones before it, it
02:03:51 3 doesn't take into account that a characteristic of the S&P
02:03:54 4 500 index is volatility and that the returns will be
02:03:58 5 different even if on average the S&P 500 returns the same in
02:04:02 6 the future as it has in the past based on the sequence of
02:04:09 7 returns; isn't that correct? It doesn't say anything about
02:04:11 8 that?

02:04:11 9 A It does not say anything about that.

02:04:11 10 Q Okay. So the later change in the language that
02:04:13 11 Mr. Martens was examining you about, that didn't have
02:04:17 12 anything to do with my line of examination about whether
02:04:19 13 volatility in the sequence of returns was taken into account
02:04:25 14 in these certifications; correct?

02:04:26 15 A The later change in the language did not change the
02:04:29 16 analysis of what we were doing.

02:04:32 17 Q Okay. Thank you.

02:04:33 18 Now, let's talk about Mr. Martens asked you a
02:04:38 19 number of questions about whether you could prevent --
02:04:43 20 present in an illustration a lapse risk statistic, like a 64
02:04:45 21 percent chance of lapse. Do you remember that?

02:04:51 22 A Yes, I do.

02:04:51 23 Q And you testified that it was your opinion that you
02:04:54 24 could not present that statistic based on the California
02:04:58 25 regulation if a part of generating that statistic was the

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02:05:03 1 use of a series of returns that in a single given year was
02:05:10 2 higher than what was depicted in the disciplined current
02:05:16 3 scale; correct?

02:05:16 4 A Yes.

02:05:17 5 Q But doesn't the regulation in California law, it
02:05:22 6 prohibits showing a scale that is more favorable to the
02:05:28 7 policyholder than the insured's illustrated scale at any
02:05:33 8 duration; isn't that correct?

02:05:33 9 A That's correct.

02:05:34 10 Q Now, if there was a 64 percent chance of lapse, that
02:05:38 11 would not be more favorable for a policyholder than what is
02:05:42 12 shown in LSW's illustration; correct?

02:05:44 13 A It depends.

02:05:45 14 Q Well, if there is a 64 percent chance that -- if the
02:05:49 15 S&P 500 returns on average the interest rate returned in the
02:05:53 16 current basis B values of the illustration, the current
02:05:56 17 basis B values of the illustration show no lapse risk,
02:06:01 18 saying there is a 64 percent chance of lapse, that would not
02:06:04 19 be more favorable to the policyholder; would it? The
02:06:10 20 illustration depicts no lapse and information is given that
02:06:13 21 there is actually a 64 percent chance of lapse even if the
02:06:17 22 S&P 500 returns that average, that would not be more
02:06:20 23 favorable to a policyholder; would it?

02:06:24 24 A A 64 percent chance of lapse in total isolation would
02:06:32 25 not be more favorable than a zero percent chance of lapse,

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02:06:38 1 assuming that all other things were within the regulation
02:06:43 2 and were equal.

02:06:45 3 Q And based on your experience and professional
02:06:48 4 expertise, what these provisions of the regulation prohibit
02:06:51 5 is showing something to the policyholder that is more
02:06:53 6 favorable than what is shown in the illustrations of
02:06:57 7 disciplined current scale; correct?

02:06:59 8 A More favorable in any given year.

02:07:02 9 Q The regulation doesn't talk about lapse risk statistics
02:07:09 10 at all; does it?

02:07:11 11 A Not that I am aware of.

02:07:12 12 Q Okay. And you understand that lapse risk statistics
02:07:16 13 can be based on average the exact same percentage shown in
02:07:20 14 the current basis B illustrations rate of return; correct?

02:07:28 15 A I don't understand the question.

02:07:29 16 Q Sure. Well, your testimony is that it would -- let me
02:07:36 17 ask you one other question. You talked about lapse risks
02:07:39 18 not being more favorable to a policyholder. Let's talk
02:07:43 19 about disclosures of reduced value.

02:07:46 20 If there was a disclosure that 90 or 95 percent
02:07:49 21 likelihood that a policyholder could suffer reduced value as
02:07:54 22 compared to what's depicted in the illustration, that type
02:07:57 23 of disclosure would not be a disclosure of more favorable to
02:08:01 24 the policyholder; would it?

02:08:02 25 A With all of the caveats and assumptions that we have

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02:08:05 1 talked about before and purely in isolation, I do not think
02:08:12 2 it would be more favorable.

02:08:13 3 Q And assuming the assumptions are correct and it's
02:08:17 4 correctly calculated and accurate, there is nothing in the
02:08:20 5 regulations that would prohibit giving that to
02:08:22 6 policyholders; is there?

02:08:23 7 A Under the assumptions that somehow one could calculate
02:08:30 8 this probability and under the assumptions that it was
02:08:36 9 viewed not to violate the part of the law that prohibited
02:08:40 10 any year being more favorable, I believe that would be
02:08:44 11 correct.

02:08:44 12 Q Okay. Even though these aren't more favorable to
02:08:50 13 policyholders, just to be clear, your opinion only pertains
02:08:54 14 to the illustration itself, correct, and what can be
02:08:57 15 displayed in that illustration?

02:09:00 16 A I'm not sure what you're asking.

02:09:14 17 (Plaintiffs' counsel conferring)

02:09:14 18 BY MR. FOSTER:

02:09:15 19 Q Just to be clear for the record, if there was a
02:09:18 20 disclosure that 90 or 95 percent of policyholders would
02:09:24 21 suffer a reduced value and that was true and correctly
02:09:27 22 calculated, that disclosure would not be more favorable to a
02:09:32 23 policyholder than what's depicted in the illustration;
02:09:34 24 correct?

02:09:35 25 A Within the caveat that I view that as an artificial

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02:09:38 1 construct, that's correct.

02:09:40 2 Q I'm asking you to assume it's correct. Do you
02:09:45 3 understand that?

02:09:46 4 A Again with your assumption, correct.

02:09:47 5 Q There is nothing in the illustration regulation that
02:09:49 6 would prohibit giving those statistics to policyholders;
02:09:52 7 correct?

02:09:53 8 A Assuming that the derivation of the statistic, if it
02:09:53 9 involved a year more favorable, that that was viewed as not
02:10:02 10 violating the law; correct.

02:10:05 11 Q Okay. And there is nothing in the illustration
02:10:09 12 regulation itself that talks about these reduced value
02:10:13 13 statistics; is there?

02:10:15 14 A Not that I am aware of.

02:10:17 15 Q Okay. And setting aside illustrations, there is
02:10:26 16 nothing that would prohibit LSW from disclosing these types
02:10:32 17 of statistics in a different type of document that it
02:10:34 18 required to be provided along with the illustrations;
02:10:37 19 correct?

02:10:38 20 A I believe a document required to be provided along with
02:10:41 21 the illustrations carries the same requirements as an
02:10:45 22 illustration.

02:10:46 23 Q You think the buyer's guide, for example, carries the
02:10:49 24 same requirements as an illustration?

02:10:54 25 A I'm not an expert in this area, but I believe to the

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02:10:57 1 extent numbers are related that are comparable to an

02:11:01 2 illustration, it would have the same concerns.

02:11:08 3 Q Okay. Well, setting aside statistics, we talked about
02:11:11 4 written disclaimers before about a risk of lapse, and such a
02:11:16 5 statement about the risk of lapse that a policyholder could
02:11:18 6 expect as a result of volatility either generally or
02:11:22 7 individually, that would not be prohibited in any way by the
02:11:27 8 regulations; correct?

02:11:28 9 A With all the assumptions and caveats, I believe that's
02:11:33 10 correct.

02:11:33 11 Q Nothing would prohibit that; correct?

02:11:36 12 A Correct.

02:11:37 13 MR. FOSTER: No further questions, Your Honor.

02:11:40 14 THE COURT: Ladies and gentlemen, we are going to
02:11:41 15 conclude here today. Thanks for spending a little bit of
02:11:41 16 additional time.

02:11:42 17 We will resume tomorrow at 8:00. Please remember
02:11:45 18 the admonition not to discuss the case with anyone and not
02:11:49 19 to form any opinions on the issues in the case until it is
02:11:53 20 submitted to you. So we will see you tomorrow.

02:12:02 21 (Jury not present)

02:12:16 22 THE COURT: Sir, you may step down.

02:12:18 23 Mr. Martens.

02:12:19 24 MR. MARTENS: Your Honor, subject to we have some
02:12:22 25 documents that we would like to move into evidence, that's

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:12:24 1 all we have.

02:12:25 2 THE COURT: Okay. I will ask you to rest again
02:12:28 3 tomorrow. I should have asked you to rest in front of the
02:12:31 4 jury.

02:12:32 5 Go ahead.

02:12:32 6 MR. MARTENS: I don't know what the Court's
02:12:32 7 pleasure is, whether it was a 50(a) motion or --

02:12:37 8 THE COURT: Well, if you're just talking about
02:12:45 9 housekeeping to make sure what you think is in is in, I will
02:12:49 10 ask the parties to get together with Ms. Tunis.

02:12:51 11 If there is something new --

02:12:53 12 MR. MARTENS: I think there is something new, and
02:12:53 13 it might be more efficient if I talk with opposing counsel
02:12:57 14 about it and then came back to the Court rather than make
02:12:58 15 the Court sort it all out now.

02:13:02 16 THE COURT: Okay. Then why don't we be in recess
02:13:02 17 for about 15 minutes, and then we will take up the motions.

02:13:08 18 MR. MARTENS: Thank you.

02:13:08 19 (Recess taken at 2:13 p.m.;

02:20:43 20 proceeding resumed at 2:25 p.m.)

02:25:22 21 THE COURT: At this time we will take up LSW's
02:25:25 22 motion to decertify and its Rule 50(a) motion.

02:25:30 23 And to the extent the plaintiffs want to make a
02:25:33 24 Rule 50(a) motion, I will take that up as well.

02:25:40 25 MR. BROSNAHAN: Your Honor, for the record I would

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:25:41 1 like to note our same objection that we made when
02:25:45 2 Ms. MacGowan was providing similar testimony. We believe
02:25:48 3 it's undisclosed expert testimony that should have been
02:25:54 4 designated that they were going to provide expert testimony.
02:25:56 5 We make a motion for a mistrial. We think it's improper and
02:26:00 6 we move to strike the testimony of the witness on the same
02:26:03 7 grounds we asserted with regard to Ms. MacGowan, that it
02:26:06 8 violates Rule 26(a).

02:26:08 9 THE COURT: Denied.

02:26:09 10 MR. BROSNAHAN: Thank you, Your Honor.

02:26:11 11 THE COURT: Okay. Mr. Martens, let's begin with
02:26:14 12 you.

02:26:16 13 MR. MARTENS: Thank you, Your Honor.

02:26:16 14 We have submitted a written motion in support of
02:26:19 15 both our Rule 26(a) and our Rule 50, so I incorporate by
02:26:25 16 reference in this oral argument all the things that I state
02:26:27 17 there.

02:26:42 18 I will try to focus here on the things that I
02:26:45 19 think are most pertinent.

02:26:48 20 With regard to the class certification motion, I
02:26:50 21 think the starting point for evaluating whether class should
02:26:53 22 be decertified is to begin with what was certified, what was
02:26:53 23 the case that the Court certified for presentation, because
02:27:02 24 I think by identifying that, it becomes clear that the case
02:27:07 25 that was tried was not the case that was certified.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:27:11 1 At docket number 353, the order granting in part
02:27:16 2 and denying in part the plaintiffs' motion to certify the
02:27:20 3 class, the Court certified a pure omissions claims case,
02:27:25 4 quote, which do not depend on any type of illustrations
02:27:28 5 provided to plaintiffs and instead consist of pure omissions
02:27:32 6 not disclosed anywhere to any applicant or policyholder.

02:27:37 7 That was the class that was certified, a pure
02:27:40 8 omissions claim which did not depend on any type of
02:27:44 9 illustration.

02:27:45 10 What we have heard throughout this trial are
02:27:48 11 various attacks on the current basis B values in
02:27:52 12 illustrations and their probability of lapsing, their
02:27:57 13 probability of being reduced, or whether additional language
02:28:01 14 should be included disclosing the likelihood that they would
02:28:06 15 suffer reduced value or be reduced. That is fundamentally
02:28:10 16 not the case that was ever certified.

02:28:14 17 The Court certified a case which did not depend on
02:28:17 18 any type of illustrations, yet the entire course of evidence
02:28:19 19 here has been -- for example, with the lapse propensity --
02:28:22 20 whether or not we should have reported the propensity that a
02:28:26 21 policy would lapse if loans were taken in the amount
02:28:28 22 illustrated.

02:28:30 23 The Court will recall this became a central issue
02:28:33 24 over what the lapse statistic was and what it applied to.
02:28:36 25 And the heading on that lapse statistic exhibit was the

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02:28:39 1 lapse propensity of the policies with loan amounts as
02:28:44 2 illustrated.

02:28:46 3 So what we have now is a case that certainly
02:28:49 4 depends on any type of illustration, directly contrary to
02:28:54 5 the class certification order. If that's the case they
02:28:57 6 tried, that's not the case that was certified.

02:29:00 7 Similarly, the reduced value is reduced value if
02:29:04 8 you take loans in the amount illustrated -- again, a case
02:29:08 9 that depends squarely on any type of illustration, directly
02:29:12 10 contrary to the case that was certified.

02:29:15 11 I think it's particularly important when you sort
02:29:18 12 of look at this from the flip side. There is no classwide
02:29:23 13 evidence of lapse propensity. I think frankly it was quite
02:29:28 14 egregious when in their opposition brief to our motion for a
02:29:30 15 Rule 23 decertification at page 12, when the plaintiffs
02:29:35 16 stated, quote: The risk of the policies do not depend on
02:29:39 17 whether any particular policyholder received an illustration
02:29:42 18 showing loans. They say Dr. Brockett's conclusions based on
02:29:47 19 the sample that 59.8 percent of Provider policies and
02:29:51 20 55 percent of Paragon policies will lapse before the
02:29:55 21 policyholder's life expectancy constitutes classwide proof
02:29:59 22 of lapse propensity bearing on the fitness of the policies
02:30:04 23 to be used for retirement income.

02:30:07 24 That quote in that brief is exactly why I objected
02:30:11 25 to that evidence at trial, because that is a misleading

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02:30:15 1 quote at best. Dr. Brockett himself said that lapse
02:30:19 2 statistic that he calculated on the 105 policies in his
02:30:24 3 sample could not be extrapolated. I asked him: Does that
02:30:29 4 even apply to the 280 policies from which the 105 was
02:30:32 5 derived? He told me, no, it could not be. In fact, his
02:30:34 6 words as I recall were it wasn't intended to tell you the
02:30:39 7 lapse probability of anything beyond that 105.

02:30:43 8 So even if you set aside the fact that the case
02:30:46 9 they have tried was not the case certified, even the case
02:30:50 10 they tried can't be a classwide case because they don't have
02:30:54 11 lapse probability as to the class. They don't even have
02:30:59 12 lapse probability as to the sample of 280, because the 280
02:31:04 13 includes many policies that don't have loans, and there's
02:31:09 14 many policies even outside the sample that don't even have
02:31:13 15 sales illustrations, only have batch illustrations, which
02:31:17 16 Dr. Brockett admitted he didn't even think could lapse.

02:31:22 17 So they have a problem with lapse probability,
02:31:24 18 even if you say, well, have they proven classwide evidence
02:31:24 19 on the case they tried, different than the one that was
02:31:30 20 certified. Even as to the case they tried, they have not
02:31:34 21 shown classwide evidence of lapse propensity.

02:31:36 22 Now, I know what happens in response to this,
02:31:38 23 which is they keep coming back to that was a sample designed
02:31:38 24 to get a ratio. The ratio is used to get damages. That's
02:31:45 25 been their tactic throughout this case, which is to meld the

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02:31:46 1 questions of was there deception and was there damage. I
02:31:51 2 think it's critical that those two elements be taken
02:31:56 3 separately.

02:31:58 4 Question one: Was there some deception? Were
02:32:01 5 people not told something that they needed to be told? In
02:32:05 6 particular, were people not told about a lapse propensity?
02:32:09 7 The answer to that is we have no evidence of lapse
02:32:14 8 propensity across the class. We have nothing that can be
02:32:16 9 extrapolated across the class as to lapse propensity.

02:32:22 10 Similarly with regard to reduced value, we know
02:32:24 11 that there is no evidence of reduced value that can be
02:32:28 12 extrapolated across the class. We know that for several
02:32:33 13 reasons, because the reduced value was only calculated as to
02:32:35 14 policies that showed loans being taken. That's problem
02:32:39 15 number one.

02:32:40 16 Problem number two is the reduced value even then,
02:32:44 17 using Dr. Brockett's Monte Carlo analysis, did not show
02:32:49 18 reduced value across the class. It showed it 95 percent of
02:32:53 19 the time on Provider and 90 percent of the time on Paragon.
02:32:57 20 Even using their analyses, you do not have classwide proof
02:33:01 21 of reduced value for all policyholders even with sales
02:33:06 22 illustrations, much less without sales illustrations.
02:33:12 23 Again, I think that's important.

02:33:14 24 Dr. Brockett said the PA/PR would be different for
02:33:17 25 batch illustrations as opposed to sales illustrations. He

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02:33:23 1 ran his PA/PR only on sales illustrations. And even then he
02:33:27 2 came up short of classwide proof of PR being over PA by his
02:33:34 3 own analysis, using even those policies that receive sales
02:33:34 4 illustrations. Five to ten percent of the time, PA is
02:33:35 5 higher than PR on average, meaning for those policyholders
02:33:49 6 who received only sales illustrations, five to ten percent
02:33:53 7 of the time there was nothing that LSW failed to tell those
02:33:56 8 people even by Dr. Brockett's own analysis. Five to
02:34:00 9 ten percent of the time for those policyholders, there was
02:34:03 10 no omission. Their policies even under his analysis would
02:34:09 11 not suffer reduced value. Those policies under his analysis
02:34:15 12 were not worth less than was represented to them.

02:34:18 13 So you can't just jump to, well, we included that
02:34:19 14 five to ten percent in calculating our average PA/PR for
02:34:22 15 purposes of damages. And that's been the constant tactic is
02:34:24 16 to say, well, we still have a classwide calculation as to
02:34:30 17 damages, because question number one is: Were those five to
02:34:33 18 ten percent of policyholders deceived and could they be
02:34:36 19 identified?

02:34:37 20 Dr. Brockett said he didn't identify them,
02:34:39 21 couldn't tell me who they are, and acknowledged that the
02:34:42 22 actual value, his PA of those policies, was higher than the
02:34:46 23 value of the policies as represented to those policyholders.

02:34:49 24 Those people did not have any material information
02:34:56 25 omitted from them under Dr. Brockett's own analysis. And

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02:34:59 1 that's only for folks who have received only sales
02:35:04 2 illustrations. We know that there's additional people who
02:35:07 3 received only batch illustrations, or stated more precisely,
02:35:10 4 there's a group of policyholders that we have no evidence
02:35:14 5 received anything other than batch illustrations.

02:35:17 6 Dr. Brockett intentionally did not run his PA/PR
02:35:20 7 analysis on those, though he was able to tell me that for
02:35:25 8 those policyholders that had both a sales and a batch
02:35:27 9 illustration, the PA/PR ratio would differ. I used the
02:35:33 10 example of Ms. Walker. So we can't draw conclusions about
02:35:37 11 what the PA/PR ratio would be for those folks who received
02:35:40 12 only batch illustrations, a number that is at least 25
02:35:46 13 percent of the class.

02:35:48 14 So even if they're allowed to shift their theory
02:35:51 15 from what was certified to this new theory of lapse
02:35:58 16 propensity and reduced value as compared to the value in
02:36:01 17 illustrations, which would be a new theory that was not
02:36:03 18 certified, they still don't have classwide proof on question
02:36:10 19 number one, which was: Was there an omission? They fail
02:36:14 20 for that reason.

02:36:17 21 Stated another way, maybe another way to think
02:36:18 22 about this is in the case of a policyholder who received an
02:36:21 23 illustration, who showed no loans, what case has ever been
02:36:27 24 tried as to that policyholder? We know that that's true of
02:36:31 25 everyone who has only a batch illustration. And in

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:36:34 1 Dr. Brockett's sample of 280 policies, I believe it was true
02:36:38 2 of 60 percent, 175 out of 280, the difference between the
02:36:42 3 105 and the 280. 175 of the 280 in his sample had even
02:36:50 4 sales illustrations that showed no loans.

02:36:52 5 THE COURT: Is that dispositive? I mean, one of
02:36:54 6 the features offered in this policy is the ability to take
02:36:59 7 loans, whether or not they are shown in the sales
02:37:01 8 illustration.

02:37:05 9 MR. MARTENS: That's true, Your Honor. I
02:37:05 10 understand that that is one of the features. And I'll
02:37:06 11 accept that for the sake of argument.

02:37:07 12 THE COURT: But isn't it just flat out true that
02:37:13 13 regardless of what your sales illustration showed, a policy
02:37:18 14 purchaser had the ability to take loans during the life of
02:37:21 15 the policy?

02:37:23 16 MR. MARTENS: Absolutely. I don't have trouble
02:37:25 17 conceding that, that that was one of the marketing features
02:37:27 18 of the policies and that was one of the actual features that
02:37:30 19 the policies could be used for.

02:37:34 20 The problem is what did that particular
02:37:36 21 policyholder think of the importance of that? In other
02:37:40 22 words, as Mr. DeSantos testified, every policyholder isn't
02:37:44 23 the same in how much they weight the relative features, and
02:37:48 24 it's not the case that -- this, I think, is critical, and I
02:37:53 25 think this goes to the heart of the Court's question. The

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02:37:56 1 plaintiffs' evidence is not that if you take loans -- let's
02:38:00 2 take even that sample of 105 policyholders where
02:38:04 3 Dr. Brockett calculated this 59.8 percent and 55.7 percent
02:38:06 4 likelihood of lapse. It was very important, the heading he
02:38:15 5 put in that document. That was the likelihood of lapse if
02:38:16 6 they took loans in the illustrated amounts.

02:38:19 7 It's not the likelihood that it will lapse if they
02:38:22 8 take loans, and that's why, if the Court remembers, I asked
02:38:25 9 a number of witness over a over: If a policy has \$500,000
02:38:26 10 in cash accumulation and you take \$500,000 in loans, will it
02:38:35 11 lapse? Yes. What if you take a dollar in loans? Will it
02:38:38 12 lapse? Probably not.

02:38:39 13 So what they've calculated is for those
02:38:42 14 individuals who elected, because it's not a default, who
02:38:45 15 elected to put loan amounts in their illustrations based on
02:38:50 16 their unique conversations with their agent, that there is a
02:38:54 17 probability calculated that those illustrations, those
02:38:57 18 policies as illustrated, would lapse.

02:39:00 19 What we don't know is what would be the
02:39:02 20 probability of lapse if they reduced the amount of their
02:39:07 21 loans by \$100 or \$500 or \$1,000 or \$10,000.

02:39:14 22 For example, even with regard to Ms. Walker, the,
02:39:16 23 I think, 61 percent risk of lapse for her policy as
02:39:21 24 illustrated doesn't answer the question can she use that
02:39:24 25 policy for retirement income without lapse. Dr. Brockett's

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02:39:27 1 analysis simply says what's the probability of lapse if she
02:39:32 2 takes \$93,167? He doesn't answer the question what if she
02:39:37 3 takes \$75,000 or what if she takes \$70,000.

02:39:41 4 I think that's why it's important for all these
02:39:44 5 individuals who don't have sales illustrations showing
02:39:46 6 loans, we have no idea -- loans, what did they want to take
02:39:50 7 in terms of loans? In what amount? In other words, there
02:39:53 8 is no evidence that they can't take loans, those other
02:39:56 9 folks. Even their analysis would only be if you take loans
02:40:00 10 in too large of an amount, it would lapse. But we don't
02:40:05 11 even know what those folks wanted to do, how much in the way
02:40:08 12 of loans did they want to take.

02:40:11 13 I think that's a critical point. The evidence is
02:40:13 14 not that you can't use these for loans without creating a
02:40:17 15 probability of lapse. It's that even accepting
02:40:20 16 Dr. Brockett's analysis, you can't use these for loans in
02:40:25 17 particular amounts. And that becomes a problem for the
02:40:28 18 60 percent of the 280 sample who show no loans, so we have
02:40:34 19 no idea in what amounts those individuals thought, expected,
02:40:37 20 or hoped to take loans, if any.

02:40:42 21 Much less, for all the folks who received only
02:40:44 22 batch illustrations which show no loans, we have no idea
02:40:45 23 what they expected, believed, or anticipated they could take
02:40:49 24 in loans and whether their belief, it all differed from
02:40:52 25 whether or not they could take loans.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:40:54 1 Let's take an example where you have someone who
02:40:59 2 got one of these sales illustrations in the 280 sample, a
02:41:04 3 sales illustration that shows no loans. It is certainly not
02:41:07 4 the case that that person can't take any loans. It's
02:41:11 5 certainly the case probably for almost all of them that they
02:41:13 6 could take a hundred dollars in loans for life.

02:41:18 7 What if that's all they wanted to do? What if all
02:41:21 8 they wanted to do is take a hundred dollars a month in loans
02:41:26 9 for life out of this policy. What if that's all someone
02:41:33 10 with an illustration with a policy the size of Ms. Walker's
02:41:33 11 but without a loan specified, what if that's all that that
02:41:33 12 person wanted to take? How do we know that reality has at
02:41:37 13 all deviated from what their anticipation was?

02:41:42 14 That becomes the problem. When there's no loans
02:41:45 15 in the illustration, we have no idea what that person
02:41:48 16 thought they could do or couldn't do and whether reality
02:41:52 17 deviates from that at all. That's the problem when they
02:41:55 18 were pushed back into this situation where all they have is
02:42:01 19 lapse rates and reduced values, lapse rates in particular,
02:42:05 20 when calculated on a sample that has loans as illustrated,
02:42:10 21 because now they can't answer the question of what is the
02:42:14 22 lapse rate of all those policies that don't have
02:42:16 23 illustrations; and what's the reduced value, if any, of all
02:42:21 24 those policies that don't have illustrations with loans in
02:42:24 25 them.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:42:24 1 So I think that is the central problem, that at
02:42:26 2 the end of the day Dr. Brockett answers a question for a
02:42:30 3 narrow slice of people, even if you accept his analysis --
02:42:33 4 and all my discussion here is accepting for sake of argument
02:42:37 5 his analysis. Even if you accept his analysis, it doesn't
02:42:44 6 tell us anything, anything about whether reality deviated
02:42:47 7 from expectations for all the people, and it is a lot. It
02:42:51 8 is a significant chunk of this class, probably over
02:42:55 9 50 percent.

02:42:56 10 THE COURT: But you're assuming that we have to
02:42:57 11 have particularized expectations. If a fact would be
02:43:01 12 material if disclosed, I think it gets around the necessity
02:43:09 13 of what the individual expectations were. It's clear that
02:43:15 14 people could take loans. Regardless of what's in the
02:43:18 15 illustrations, if the fact was that they took loans, just
02:43:24 16 say for sake of example, over four years the amount of
02:43:28 17 ten percent of whatever the balance was, they would lapse.

02:43:34 18 Now, they didn't have it presented to them in the
02:43:38 19 policy illustration. I assume there are a number where
02:43:42 20 there was no loans shown in the illustration, but
02:43:45 21 nevertheless the theoretical defect would be there if they
02:43:50 22 acted in a way that would trigger a lapse. And that wasn't
02:43:55 23 disclosed without regard to what's in the policy
02:44:01 24 illustrations.

02:44:01 25 Let me give you this example: Suppose I go to the

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02:44:03 1 auto dealer and I tell him I want to buy this car and most
02:44:07 2 of the time I really just drive around the neighborhood. I
02:44:12 3 live in a small town, probably don't drive 15 miles a week,
02:44:20 4 never go over 30 miles an hour. And the fact of the matter
02:44:21 5 is there is some key defect in the engine that comes into
02:44:26 6 play when you go 50 miles an hour.

02:44:28 7 Now, the person bought the car with the
02:44:30 8 expectation of driving only a few miles and not going more
02:44:35 9 than 25 miles an hour, but that defect was there. And it
02:44:38 10 seems to me what the plaintiffs are saying. The defect in
02:44:43 11 my hypothetical of a car having a catastrophic problem when
02:44:47 12 you put it over 50 is there and would be material to
02:44:48 13 somebody even if they said, you know, usually I just drive
02:44:53 14 around here, but some day I might want to go out on the
02:44:58 15 freeway. I think the argument is -- and I think there's at
02:45:00 16 least proof enough here to sustain it -- that the
02:45:03 17 undisclosed facts would be material even if you didn't have
02:45:08 18 an immediate intention to invoke the facts that would bring
02:45:13 19 the defect into play.

02:45:16 20 MR. MARTENS: Here is why I don't think that
02:45:17 21 analogy holds, Your Honor. It's undisputed -- I can't
02:45:22 22 imagine we have to disclose the fact that if you take loans
02:45:26 23 in an amount that runs your account dry, your policy will
02:45:30 24 lapse.

02:45:31 25 THE COURT: But aren't you free to argue that off

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02:45:34 1 the face of the policy illustrations and the testimony here?

02:45:36 2 MR. MARTENS: Right. But the problem is what's
02:45:38 3 the evidence that anyone didn't know that obvious fact on a
02:45:41 4 classwide basis? In other words, what's the defect that we
02:45:45 5 didn't disclose? That if you take loans that run your
02:45:48 6 account value dry, you will lapse?

02:45:51 7 THE COURT: No. It's the interplay between the
02:45:53 8 loans and the volatility. That's the issue. I mean, the
02:45:58 9 claim is not that if you take loans, your policy will lapse.
02:46:01 10 The claim goes deeper. The argument is that there is a
02:46:04 11 relationship between taking loans and volatility which
02:46:07 12 accelerates or exacerbates the probability of lapse.

02:46:12 13 MR. MARTENS: Well, I think their theory is
02:46:17 14 something quite different, which is that the interplay
02:46:19 15 between the features and the S&P reduces the value of the
02:46:23 16 policy, reduces the cash value, and thus that reduces the
02:46:26 17 amount of loans you can take.

02:46:27 18 THE COURT: Well, but in turn if it reduces the
02:46:31 19 value, it increases the insurance expense because you have
02:46:34 20 got the amount between the value in the policy at the moment
02:46:37 21 and the face value of the insurance. If the value goes
02:46:41 22 down, what you're paying in insurance premiums goes up.

02:46:44 23 MR. MARTENS: Well, I don't think there's any
02:46:45 24 evidence about how much that cost of insurance is affected
02:46:47 25 at all. There is no testimony about the amount, that that

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:46:51 1 would at all be material. In fact, the only evidence on how
02:46:55 2 much cost of insurance was the one dollar change that we
02:47:02 3 offered. They offered no evidence on the cost of insurance.

02:47:02 4 THE COURT: There is plenty of evidence that there
02:47:04 5 is a relationship between expenses affecting the value of
02:47:11 6 the fund in the policy and there being a relationship
02:47:16 7 between that and what it costs you for insurance. Yeah, the
02:47:19 8 max rates are all laid out, but the question is if I go into
02:47:24 9 this, assuming a \$2.5 million policy, that I'm going to have
02:47:31 10 to insure \$2 million is different from if I am going to have
02:47:35 11 to insure \$2,250,000.

02:47:40 12 MR. MARTENS: My question there is what haven't we
02:47:43 13 disclosed on that? Do we really need to tell people when
02:47:47 14 you're charged a charge, your value will go down?

02:47:54 15 THE COURT: Under the theory it's not as simple as
02:47:57 16 that. There is a factor not disclosed -- namely,
02:47:59 17 volatility -- under the plaintiffs' theory that drives the
02:48:04 18 acceleration of costs, therefore drive value down, therefore
02:48:07 19 increases the likelihood of lapse. That's the key piece. I
02:48:12 20 agree you don't have to tell people if you take all the
02:48:13 21 money out of the policy, your policy will lapse. I think
02:48:17 22 that's almost self-evident. But I think it's more subtle
02:48:21 23 that that.

02:48:22 24 MR. MARTENS: As I understand what the Court is
02:48:24 25 articulating, their new theory, again not the theory that

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02:48:28 1 was certified, because the value is reduced, reduced
02:48:32 2 relative to what, is the question. To say that the value is
02:48:37 3 reduced from what people expected, you have to answer the
02:48:40 4 question: Reduced relative to what? In what way does this
02:48:47 5 policy have reduced value? Reduced requires a benchmark,
02:48:52 6 and that's why the illustrations have always been critical.

02:48:57 7 Their pure omissions case, as I understood
02:48:58 8 initially, was they thought they were going to show these
02:48:58 9 things have high lapse rates classwide, and they would then
02:49:02 10 be able to say no consumer expected these things would have
02:49:06 11 a 90 percent lapse rate. The problem was they didn't
02:49:09 12 actually have that evidence, and they didn't have
02:49:12 13 Dr. Brockett calculate a classwide lapse rate. But they
02:49:15 14 could say no consumer would have expected these things would
02:49:15 15 lapse 90, 80, whatever percent they expected when they
02:49:19 16 started this case.

02:49:20 17 So they fell back to this reduced value theory,
02:49:24 18 but that begs the question of reduced relative to what.
02:49:29 19 What is the benchmark that any particular policyholder
02:49:32 20 expected and now the reality for them is different?

02:49:36 21 What we have heard is that for some sample that
02:49:39 22 can't being extrapolated classwide, their value might not
02:49:43 23 match up to what was illustrated. That's the key point --
02:49:47 24 to what was illustrated. And there is no evidence here.

02:49:49 25 So to use your car example, not everyone buying a

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02:49:53 1 Toyota Corolla would understand --

02:49:55 2 THE COURT: Don't use that.

02:49:56 3 MR. MARTENS: I'm sorry. I don't remember what
02:49:57 4 car you used. I'll pick another one -- Volkswagen --

02:50:02 5 THE COURT: A generic car.

02:50:04 6 MR. MARTENS: A generic car. No one would expect
02:50:06 7 that you could drive a generic starter car 150 miles an
02:50:11 8 hour. So to say that the car only accelerates up to 100
02:50:15 9 wouldn't be a defect.

02:50:18 10 THE COURT: No, but in my hypothetical there was a
02:50:20 11 defect if you went 50 miles an hour.

02:50:23 12 MR. MARTENS: And that's the key point, is because
02:50:23 13 a consumer going into that would certainly expect I can
02:50:26 14 drive my car 50, because that's what cars do. I think
02:50:29 15 that's why that example is fundamentally different, because
02:50:32 16 it would be easy to establish that consumers expect that I
02:50:35 17 could drive the car 50 miles an hour.

02:50:38 18 THE COURT: But the analogy is between the person
02:50:41 19 who doesn't have loans in the policy illustration and the
02:50:44 20 person who says I'm just going to drive 25 miles an hour
02:50:48 21 around my little town ten miles a week. Neither person
02:50:53 22 expected to encounter the defect but questions whether the
02:50:57 23 defect is there under certain conditions. That's the
02:51:00 24 defect.

02:51:01 25 MR. MARTENS: So using your analogy, if someone

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02:51:05 1 only intended to drive 25 miles an hour and the car wouldn't
02:51:09 2 go above 50, and the normal consumer would think you could
02:51:13 3 drive your car above 50, I think in that instance it's easy
02:51:18 4 to understand the defect. And the reason is because the
02:51:20 5 consumer would expect I can drive my car above 50.

02:51:26 6 But I think that's the critical piece, that the
02:51:26 7 Court is assuming rather than expecting you'd have to prove,
02:51:26 8 and it would probably be easy to prove, but would
02:51:26 9 nonetheless have to prove, which is, a reasonable consumer
02:51:26 10 would expect you could drive this car above 50 when in fact
02:51:36 11 you can only drive it 25.

02:51:39 12 So using that analogy here, what's the 50? What's
02:51:42 13 the amount that a reasonable consumer would expect you could
02:51:46 14 take out of this policy? I don't know of any evidence of
02:51:51 15 that. That's the critical missing piece. What they say is
02:51:53 16 at some point way up here you can't hit 150 miles an hour
02:51:59 17 with a starter car. Maybe you can't hit 125 miles an hour.
02:52:03 18 But where's the evidence that any consumer thought you could
02:52:05 19 get to that amount for all of those consumers who have no
02:52:10 20 illustrations showing loans. I think that's the critical
02:52:13 21 difference.

02:52:14 22 It's not like the car where everybody thinks you
02:52:17 23 can drive a car 50 miles an hour. Everybody doesn't think
02:52:22 24 you can take a loan in some indeterminate amount. That
02:52:25 25 expectation has to come from somewhere, and that's what they

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02:52:28 1 don't have on a classwide basis. They don't have that
02:52:28 2 benchmark, that 50 miles an hour where you say it can't live
02:52:33 3 up to that. It has got some reduced value that you didn't
02:52:36 4 tell me about.

02:52:38 5 I am not here fighting about how people would use
02:52:40 6 it, even whether they would take advantage of the full loan
02:52:44 7 amount. My question is what is that amount. For all those
02:52:48 8 people who have illustrations with no loans, what is that
02:52:52 9 50 miles an hour here? What is that comparable benchmark
02:52:56 10 that we can say it doesn't live up to? I think that's the
02:53:00 11 problem they have. They don't have that benchmark that can
02:53:04 12 be extrapolated out so that we can evaluate it for those who
02:53:08 13 have no illustrated loans.

02:53:11 14 For those who have an illustrated loan, I think
02:53:15 15 their benchmark is wrong, but I understand the Court's
02:53:16 16 point, which is that's the 50 miles an hour. But what about
02:53:18 17 all those policies that don't have that? What is that
02:53:22 18 benchmark that someone must have thought this thing would
02:53:27 19 perform at? I think that is a fundamental failing in the
02:53:31 20 proof.

02:53:32 21 As I said, for all those folks who we don't know
02:53:36 22 how much loan they wanted to take or how much loan they
02:53:39 23 thought they could take, what's the omission? What didn't
02:53:43 24 we tell them? What benchmark did we tell them this policy
02:53:49 25 won't live up to? What did we need to say? It will not

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:53:53 1 allow you to do what? And how is that what any different
02:53:56 2 than what they expected? We just don't know for any of
02:53:59 3 those individuals.

02:54:02 4 More importantly, we know -- not more importantly
02:54:03 5 but equally important, we know that for five to ten percent
02:54:09 6 of those individuals, even in the sample, it would go above
02:54:15 7 50 miles an hour. So to use the Court's example, those
02:54:19 8 folks thought they could drive that car 50 miles an hour.
02:54:22 9 It turns out they can drive it 75 miles an hour. Their car
02:54:28 10 didn't have a defect even under the plaintiffs' theory.
02:54:30 11 Five to ten percent of the time their car would go 75. So
02:54:36 12 what did we fail to tell them? What is it that we have
02:54:40 13 omitted to that part of the class?

02:54:42 14 Again, I think all of this is a new theory that
02:54:45 15 was never certified. But even under this new theory, they
02:54:47 16 can't show what the lapse rate is classwide. Dr. Brockett
02:54:52 17 said it cannot be extrapolated. And the reduced value, even
02:54:56 18 if it can be extrapolated, shows that five to ten percent of
02:54:58 19 the time -- in fact, I asked him this. I said: Would you
02:55:01 20 expect your 280 sample and your reduced value 90 to 95
02:55:04 21 percent of the time, would you assume that that can be
02:55:07 22 extrapolated? I believe he said, yes, he would expect that
02:55:09 23 to repeat itself because it's a statistical sample, and
02:55:16 24 that's what damns his model, because that shows that five to
02:55:21 25 ten percent of the time in the 46,000, even under his

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:55:22 1 analysis, the car drives faster.

02:55:27 2 We do not have classwide proof on that. Five to
02:55:33 3 ten percent of the time the car drives faster than 50, under
02:55:37 4 Dr. Brockett's own analysis. And we have no idea who those
02:55:40 5 people are, yet they're going to stand up and demand damages
02:55:43 6 for the class. And we have no idea who the five to
02:55:48 7 ten percent are whose car goes faster.

02:55:49 8 We literally have folks in here who were not
02:55:50 9 deceived. We know that even under Dr. Brockett's analysis.
02:55:54 10 They were not deceived. I don't care whether those five to
02:56:00 11 ten percent were used to calculate the average PA/PR to get
02:56:02 12 damages. Those five to ten percent were not deceived.

02:56:07 13 THE COURT: But you fix on the nature of the
02:56:09 14 illustration rather than the existence of a defect without
02:56:13 15 regard to what's in the illustration.

02:56:16 16 MR. MARTENS: Well, those five to ten percent,
02:56:19 17 what's the defect? I don't even know what the defect is for
02:56:27 18 those people. I don't know what we failed to tell them. We
02:56:30 19 failed to tell them that your policy as it works will do
02:56:34 20 better than we tell you. Yours is not defective even under
02:56:39 21 Dr. Brockett's analysis.

02:56:42 22 I understand what the Court is saying, that
02:56:44 23 Dr. Brockett's analysis, if you accept it, shows defect as
02:56:46 24 to 90 to 95 percent. It does not show that as to the five
02:56:53 25 to ten percent. Their car drives faster. It does not have

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:56:57 1 a defect. It does not blow up when you cross 50 miles an
02:57:02 2 hour. So for that part of the class, we didn't omit
02:57:05 3 anything to them. Nothing. We would have lied to them had
02:57:09 4 we told them their policy was defective. We would have told
02:57:14 5 them something that was false, because it's not.

02:57:17 6 It would be like telling the car owner your car
02:57:21 7 won't go above 50 when it will. So I think even under this
02:57:26 8 new theory that has developed at trial, the reduced value
02:57:29 9 theory, it doesn't even apply classwide. The lapse
02:57:33 10 certainly doesn't, the lapse probability, because
02:57:35 11 Dr. Brockett testified you cannot extrapolate that
02:57:38 12 59.8 percent and that 55.7 percent. You cannot extrapolate
02:57:42 13 it. He admitted that. He said it wasn't even meant to be
02:57:47 14 extrapolated to the 280. That theory is gone by his own
02:57:51 15 analysis because he acknowledged they're pushed back now to
02:57:53 16 this reduced value theory. And the reduced value theory
02:57:57 17 does not apply classwide either.

02:58:01 18 At the end of the day, we would have lied to
02:58:04 19 people had we told them that it may be lower when in fact it
02:58:06 20 can drive faster than 55. I think that's the first -- this
02:58:13 21 is just issue one on was there even deception.

02:58:18 22 The additional issue for matters of class
02:58:21 23 certification are that they have a damages problem, and that
02:58:27 24 is that Dr. Brockett's approach, which I don't believe is a
02:58:31 25 legitimate approach, but he looks at how much market value

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

02:58:35 1 would have moved. And thus how much people were overcharged
02:58:39 2 I think fails on two respects. Number one, it's not the
02:58:43 3 law. This may be somewhat Rule 50 but also Rule 23. You
02:58:51 4 have to calculate what's the highest amount a willing buyer
02:58:54 5 would pay and compare that to what they actually paid.

02:59:00 6 Maybe this is a Comcast problem; maybe this is a
02:59:02 7 Rule 50. I think in some way it all merges together here.
02:59:06 8 I read him the definition from the instructions and said:
02:59:10 9 Did you do this calculation? And he told me no. I asked
02:59:15 10 him again after plaintiffs' counsel tried to muddle it up on
02:59:21 11 redirect, and I went back on recross and said I just want to
02:59:25 12 be clear. And he said: I didn't do that calculation. He
02:59:30 13 did not do the willingness to pay calculation as defined in
02:59:34 14 the law.

02:59:35 15 What he did instead was he tried to look at how
02:59:38 16 much market price shifted. This is where the POM beverages
02:59:43 17 case comes into play. In POM beverages the Court said: We
02:59:48 18 think it highly doubtful that you can use this increased
02:59:51 19 market price as a valid measure of fraudulent concealment
02:59:54 20 damages. But if you can, you can only do it if there is an
02:59:58 21 efficient market. You can only say the misinformation would
03:00:02 22 have inflated the market price if the market was efficient.

03:00:08 23 Again, Dr. Brockett said in no uncertain terms
03:00:11 24 that the market is not efficient. The market for IULs is
03:00:14 25 not efficient. He used the exact same definition of

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03:00:21 1 efficiency right out of POM. So even if you accept that
03:00:25 2 what he did was a willingness to pay, even though he
03:00:29 3 disclaimed that he used willingness to pay as defined, even
03:00:29 4 if you accept that his market analysis of how much market
03:00:33 5 price would move was a willingness to pay analysis, it only
03:00:38 6 works according to the POM beverage case in an efficient
03:00:42 7 market.

03:00:43 8 You can only assume that a \$1 change in value of
03:00:46 9 the policy will have a \$1 change in the price of the policy
03:00:50 10 if the market is efficient, if the market incorporates that
03:00:54 11 information on an efficient basis. And Dr. Brockett denied
03:00:58 12 that the market is efficient.

03:01:02 13 So even if you can use that theory -- and that's a
03:01:05 14 big if according to POM -- I don't think even think it's a
03:01:09 15 big if when Dr. Brockett denies that he used the definition
03:01:14 16 in the statute. But you can't do it if the market's not
03:01:14 17 efficient. So again they have no classwide evidence of
03:01:17 18 damages.

03:01:19 19 Finally I'd say this. Dr. Brockett tries to save
03:01:23 20 the day to some degree by recasting the damages as intrinsic
03:01:29 21 value. I think the short answer on intrinsic value is he
03:01:33 22 used the same calculation. That's not intrinsic value.
03:01:36 23 Intrinsic value doesn't look at market price. By definition
03:01:39 24 intrinsic value doesn't look at market price. We can give
03:01:42 25 the Court a case from the Ninth Circuit that explains that

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03:01:45 1 when you're looking at intrinsic value, you look at such
03:01:49 2 things as how much did it cost to build it, or what type of
03:01:54 3 emotional worth does it have. Some of the examples are like
03:01:56 4 how do you figure out what the value of a cat is if you lost
03:02:00 5 your cat.

03:02:01 6 You can look to the intrinsic value -- or how much
03:02:05 7 is a ship worth that's sunken in the ocean, because there is
03:02:10 8 no market for that? The Court said, well, you could look at
03:02:14 9 how much it cost to build minus any deterioration in the
03:02:18 10 product. But they don't have anything that looks like that.
03:02:21 11 Dr. Brockett took literally the same calculation, slapped a
03:02:26 12 new label on it, and calls it intrinsic value.

03:02:30 13 So at the end of the day I think their case fails
03:02:34 14 to show classwide that there was a lapse statistic that
03:02:37 15 applied classwide. They have no evidence of that at all.
03:02:39 16 With regard to reduced value, they have 90 to 95 percent of
03:02:44 17 policies, if you accept the analysis, but ten percent of the
03:02:48 18 time the car could drive faster than 50 miles an hour. And
03:02:53 19 their damage model does not line up because Dr. Brockett
03:02:57 20 said he did not analyze willingness to pay, the definition
03:03:01 21 out of the jury instructions. And his fall-back approach,
03:03:06 22 which is to look at market price, doesn't work in the
03:03:08 23 absence of an efficient market.

03:03:10 24 That's my Rule 23 argument. I can make the
03:03:11 25 Rule 50 argument now if you want to hear from Mr. Brosnahan.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:03:11 1 We have many additional arguments on Rule 50.

03:03:20 2 THE COURT: Let me hear from Mr. Brosnahan,
03:03:23 3 please.

03:03:24 4 MR. BROSNAHAN: Thank you, Your Honor. I think
03:03:26 5 the Court grasped quite well that our case is a defect case.
03:03:31 6 It's an omissions case. Mr. Martens jumped right over that
03:03:35 7 fact and immediately started attacking what you do with the
03:03:37 8 illustrations.

03:03:41 9 The theory of the case is that these policies are
03:03:44 10 not fit for the purposes for which they are designed and
03:03:48 11 marketed, and the consumer expectations center around the
03:03:53 12 purposes for which the products were designed and marketed.
03:03:56 13 The evidence is that they were designed and marketed for a
03:03:58 14 cash accumulation and in particular for retirement income.
03:04:03 15 Yes, there is a death benefit, because that's a requirement
03:04:06 16 in order to get the tax benefits.

03:04:09 17 Mr. Tivilini testified that you would never buy
03:04:13 18 this policy if all you wanted was a death benefit. There is
03:04:17 19 no evidence in the record about riders. Whatever different
03:04:19 20 case that could have been is not before us. This is a case
03:04:20 21 about consumers buying a policy for cash accumulation and in
03:04:24 22 particular retirement income and thinking that that product
03:04:28 23 is a safe and secure way to accomplish that end.

03:04:34 24 The problem is that the defect is volatility. The
03:04:38 25 way it interacts with this policy produces lapse rates, and

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03:04:43 1 it produces reduced value. Those are two different aspects,
03:04:48 2 but we think that the consumer expectation is that
03:04:53 3 volatility is not going to be interacting with this policy
03:04:59 4 design, is not going to produce a high risk of lapse, and is
03:05:01 5 not going to reduce the value of the policy versus a
03:05:05 6 situation of no volatility.

03:05:07 7 He was asking, okay, what's the 50? The 50 is no
03:05:11 8 volatility. The 50 is volatility that doesn't affect your
03:05:14 9 policy.

03:05:15 10 THE COURT: What do you do with the fact that
03:05:17 11 Dr. Brockett could not extrapolate his lapse rates from 105
03:05:21 12 who had loans to the whole class of 46,000?

03:05:30 13 MR. BROSNAHAN: That's a completely false
03:05:34 14 assertion for exactly the reason Your Honor raised.

03:05:34 15 THE COURT: Did he not say that you couldn't
03:05:37 16 extrapolate that finding to the class?

03:05:39 17 MR. BROSNAHAN: I think he said you can't
03:05:40 18 extrapolate it to the other illustrations. But you can
03:05:44 19 extrapolate it to the class because what it is is a measure
03:05:47 20 of a failure rate. It is a measure of a failure rate. And
03:05:51 21 it is a failure rate that is based on 105 realistic
03:05:57 22 retirement income plans that were prepared for real people.

03:06:04 23 I don't have in mind the exact questioning and
03:06:08 24 answering. I think Mr. Martens did a very good job of
03:06:12 25 manipulating the testimony of Dr. Brockett. I suppose

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03:06:16 1 that's to his credit as a cross-examiner. I didn't have an
03:06:20 2 opportunity, as the Court will recall, to have the final
03:06:21 3 opportunity with Dr. Brockett. But there is no question in
03:06:24 4 this case that the 105 policy sample reflects a failure rate
03:06:31 5 for 105 real retirement plans. It's being used to prove
03:06:38 6 that the defect exists. If you tried to use this policy for
03:06:44 7 a realistic retirement plan, you have a high rate of
03:06:48 8 failure.

03:06:49 9 That's what that statistic proves. And it's true
03:06:49 10 of the product. He keeps acting as if these statistics are
03:06:54 11 about particular people. No. They are true of the product
03:06:59 12 and how the product can be used across the range of
03:07:02 13 situations that people would expect to use it.

03:07:05 14 The Court pointed to the fellow who didn't expect
03:07:08 15 to drive, didn't plan to drive 50, but he knows that
03:07:11 16 sometime he might want to go on the freeway. So it's an
03:07:14 17 important fact to him that the car can be driven above
03:07:19 18 50 miles an hour.

03:07:21 19 Similarly, whether I have an illustration that
03:07:25 20 illustrates loans or not, the ability to use the policy for
03:07:29 21 loans for retirement income is important to me regardless.
03:07:33 22 So the 105 policy sample is data about the policy. It's not
03:07:40 23 data about somebody else's illustration.

03:07:43 24 So when Dr. Brockett said I can't extrapolate it
03:07:45 25 to these other illustrations, of course he can't. He was

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03:07:48 1 measuring those illustrations. But what those illustrations
03:07:52 2 had in common was exactly what we need to prove here. The
03:07:57 3 relevant thing is these are the realistic retirement plans,
03:07:59 4 and what is the failure rate of those plans.

03:08:00 5 That's why he didn't use batch illustrations. The
03:08:03 6 testimony is unequivocal that batch illustrations do not
03:08:07 7 reflect retirement plans at all, so that's why you don't use
03:08:10 8 those. Plans that don't have loans, those are not
03:08:15 9 retirement income plans. So you don't use those.

03:08:17 10 You use only the plans that reflect loans because
03:08:19 11 those are the retirement income plans. Therefore, his
03:08:21 12 statistic shows that there is a high failure rate when you
03:08:24 13 try to use the policy for a realistic retirement income
03:08:30 14 plan. And that's what that data shows.

03:08:32 15 With respect to the reduced value aspect of it,
03:08:36 16 Mr. Martens is wrong because that is not limited to policies
03:08:41 17 with loans. That's the entire 280 policy sample. What it
03:08:46 18 demonstrates is that when you buy that policy, volatility is
03:08:54 19 biasing your value downward. Volatility can be expected to
03:09:02 20 reduce the expected value of that policy below what it would
03:09:05 21 be if volatility did not interact with that policy.

03:09:08 22 And it doesn't matter who got what illustration.
03:09:10 23 If, for example, Mr. Foster happened to get an illustration
03:09:14 24 that put him in the five to ten percent and I got an
03:09:17 25 illustration that put me in the 90 to 95 percent, on day one

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:09:23 1 we are both buying the same policy. Again, this is a
03:09:27 2 statistical sample that demonstrates the characteristics of
03:09:31 3 the product, not the characteristics of the illustration.
03:09:34 4 The illustration is just the data from which we deduced the
03:09:38 5 characteristics of the product.

03:09:41 6 The day after we buy our policies, I could go off
03:09:45 7 and pay premiums and take loans the way it was shown in his
03:09:48 8 illustration, or he could do the reverse with me. But
03:09:52 9 that's not how you assess damages. It's not how you assess
03:09:54 10 the truth of a representation. You have to look at the time
03:09:57 11 of sale. At the time of sale these policies were biased in
03:10:01 12 a negative direction as compared to a situation where
03:10:05 13 volatility did not interact with the policy design.

03:10:09 14 So you don't consider what may happen 30 years
03:10:12 15 down the line how somebody might actually end up using the
03:10:14 16 policy. Those are all ex post considerations. So the data
03:10:19 17 that Dr. Brockett has adduced shows the defects in those two
03:10:23 18 important aspects of the policy which we believe any
03:10:27 19 reasonable consumer would expect, and we think the jury is
03:10:31 20 entitled to find that people would expect these products to
03:10:36 21 function without this vulnerability to volatility.

03:10:42 22 I think that addresses the arguments he made on
03:10:45 23 the first point.

03:10:47 24 THE COURT: Let me stop you there. You're saying
03:10:49 25 notwithstanding the fact that his analysis showed that five

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03:10:53 1 to ten percent of his sample didn't have reduced value and
03:10:58 2 that that could be extrapolated to the class, there is
03:11:03 3 nevertheless a showing on a classwide basis?

03:11:06 4 MR. BROSNAHAN: Absolutely, because he is showing
03:11:08 5 the propensities of the policy. You have to remember the
03:11:10 6 product is the policy; it's not the illustration. It's not
03:11:13 7 like I bought an illustration that had more value in it.
03:11:16 8 You bought a policy, and the statistics show the
03:11:20 9 characteristics of the policy. How people will end up using
03:11:23 10 the policy in the future, nobody knows. But on day one I
03:11:28 11 bought a policy, and the statistics show that the chances of
03:11:32 12 that policy having the same value it would have if
03:11:36 13 volatility did not interact with it are very, very poor.

03:11:42 14 THE COURT: Are very, very --

03:11:44 15 MR. BROSNAHAN: The chances are high that it will
03:11:45 16 not have the same value that it would have if it did not
03:11:50 17 interact with volatility.

03:11:52 18 THE COURT: Is the chances that the probability of
03:11:54 19 reduced value will be high the same as proof on a class
03:11:58 20 basis?

03:12:00 21 MR. BROSNAHAN: Absolutely, because it's proof
03:12:02 22 about the characteristic of the product. There is nothing
03:12:08 23 individualized about that other than the fact that a
03:12:12 24 different person's illustration was used to calculate the
03:12:16 25 data, because how the person chooses to have it illustrated

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:12:20 1 does not reflect how the product is going to be used in the
03:12:24 2 future. We don't know how the product is going to be used
03:12:29 3 in the future. It's an ex post consideration. But they're
03:12:31 4 all buying the same policy on day one.

03:12:32 5 THE COURT: So you're saying with respect to the
03:12:35 6 five or ten percent that showed an increased value, that
03:12:40 7 they may be subject to the defect effect based on the way
03:12:46 8 they use the policy, and that's not disclosed to them?

03:12:53 9 MR. BROSNAHAN: Absolutely. That's the first
03:12:58 10 issue.

03:12:59 11 With respect to the damages issue, first of all, I
03:13:02 12 think this issue that the defense keeps raising about the
03:13:06 13 highest amount a willing buyer would pay is a gross
03:13:11 14 misrepresentation of the law. In fact, I think that the
03:13:12 15 Court should -- well, we had asked that the instruction be
03:13:15 16 clarified because we think that the BAJI instruction is more
03:13:20 17 clear.

03:13:20 18 The premise of it is that you don't look at market
03:13:24 19 value at all. You look at each individual person's
03:13:27 20 subjective willingness to pay. It's the same argument they
03:13:32 21 made at the discovery phase. I believe they raised it again
03:13:36 22 in class certification. The Court rejected it both times.
03:13:40 23 They're making it again just because of a vague formulation
03:13:42 24 in the instruction that speaks of the highest price that a
03:13:44 25 willing buyer would pay.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:13:45 1 He asked Dr. Brockett: Is that what you looked
03:13:48 2 at? Dr. Brockett said: No, that wasn't what I looked at,
03:13:52 3 because Dr. Brockett in fact looked at market value, which
03:13:54 4 is what he was supposed to look at.

03:13:55 5 On reexamination I clarified that, yes, a willing
03:14:00 6 buyer might be -- a person might be willing to pay more if
03:14:03 7 he had to; but if the market price were lower, he wouldn't.
03:14:08 8 No willing buyer would pay more than the market price
03:14:11 9 because he doesn't have to pay more than the market price,
03:14:16 10 and that's the ambiguity in the instruction that Mr. Martens
03:14:19 11 is seeking to exploit and to totally gut the market-value
03:14:22 12 test and convert it into an individualized subjective test.

03:14:27 13 I went through this with Dr. Brockett. So if the
03:14:31 14 price of POM is \$3 in the marketplace and Mr. Martens
03:14:35 15 happens to like it a lot and would be willing to pay \$5,
03:14:39 16 what does he have to pay? Well, of course, he only has to
03:14:44 17 \$3. And that's the market price. So that's what determines
03:14:46 18 fraud damages, not an individual subjective valuation.

03:14:50 19 As I said, that was previously litigated, and
03:14:50 20 there is just no question under the cases that you look at
03:14:56 21 market value, not individual subjective value.

03:15:01 22 THE COURT: But the CACI instruction talks about
03:15:03 23 the price which a willing buyer and a willing seller would
03:15:07 24 strike.

03:15:09 25 MR. BROSNAHAN: Right. But by definition that is

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03:15:10 1 bounded by the market price. It's supposed to be a market
03:15:15 2 price. It's just a vague formulation because, as I say, no
03:15:18 3 willing buyer would willingly pay more than the market
03:15:21 4 price. So the market price sets a bound on the price you
03:15:27 5 pay. Even if he would be willing to pay \$5 if the market
03:15:31 6 price were \$5 -- if the price went from to \$3 or \$5, some
03:15:34 7 people would say: Forget it. I value it at \$3.50. I am
03:15:40 8 not going to buy it anymore.

03:15:41 9 There may be other people who say: Okay. If it's
03:15:4110 \$5, I like it a lot and I will still buy it. But if the
03:15:4111 price were \$3 in the market, that person would say, no, I
03:15:4712 won't pay \$5 because I can get it for \$3.

03:15:5113 THE COURT: Unless you go to the wrong grocery
03:15:5514 store.

03:15:5615 MR. BROSNAHAN: Well, then you're talking about
03:15:5816 what exactly is the relevant market, which I think is a
03:16:0117 separate issue. But there's no question under the law that
03:16:0118 you're supposed to look at market value, that individual
03:16:0419 preferences that might cause someone to be willing to pay
03:16:0720 more than the market price, they're completely irrelevant
03:16:0721 because otherwise that destroys the market value test.

03:16:1522 In fact, Mr. Martens drew supply and demand first.
03:16:2123 He drew them backwards, of course. But everyone, when you
03:16:2224 have that market price line going across at the intersection
03:16:2625 of supply and demand, everyone on that demand curve that's

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03:16:30 1 above that horizontal line by definition values the product
03:16:34 2 more than the market price. But none of them have to pay
03:16:37 3 more than the market price because that's the nature of a
03:16:37 4 market price.

03:16:43 5 So in the market value test, you throw out all of
03:16:46 6 those individualized preferences and you look at the market
03:16:50 7 price, because that's what a willing buyer would actually --
03:16:52 8 the highest he would actually be willing to pay because he's
03:16:55 9 not going to be willing to pay more than he has to, and he
03:16:59 10 doesn't have to pay more than the market price.

03:17:00 11 So I would again urge the Court to take another
03:17:03 12 look at the BAJI instruction, which I think is a little bit
03:17:06 13 more clear on this, so that we don't have this argument
03:17:09 14 there tomorrow to confuse the jury.

03:17:14 15 With respect to POM, POM is a fraud in the market
03:17:18 16 case. That was their theory. They needed that --

03:17:20 17 THE COURT: I think you have adequately
03:17:23 18 distinguished POM.

03:17:24 19 MR. BROSNAHAN: Thank you, Your Honor.

03:17:25 20 With respect to intrinsic value, I think
03:17:27 21 Mr. Martens has it backwards. His perspective is, well,
03:17:32 22 okay, Dr. Brockett did the market value test and then he did
03:17:36 23 the intrinsic value test, and it's the same thing. It's the
03:17:39 24 other way around. The intrinsic value test is the building
03:17:44 25 block where Dr. Brockett -- in terms of the mathematics,

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03:17:45 1 Dr. Brockett took the market price as a starting point, as a
03:17:51 2 reference point, market price based on the way the product
03:17:55 3 is represented to the market.

03:17:57 4 He then calculated the discount off that price in
03:17:59 5 terms of how the product as it actually performs falls short
03:18:07 6 of the performance as represented to the market.

03:18:11 7 So it's a totally internal type of analysis
03:18:16 8 without referring to, you know, what would change in a
03:18:17 9 but-for world if disclosure were made. And it's based on
03:18:24 10 cash flows as you would value any investment. But you're
03:18:28 11 taking the market price as given and you are calculating the
03:18:28 12 cash flows and calculating how much it's really
03:18:32 13 intrinsically worth.

03:18:35 14 The market value test then takes a further step
03:18:38 15 and says if there were full disclosure, the market price
03:18:43 16 would fall to the level of the intrinsic value. So it's the
03:18:46 17 market value test that kind of has this sort of extra step
03:18:50 18 in it. The intrinsic value test is the simpler test. The
03:18:53 19 law is clear that in situations where market value is
03:18:57 20 difficult to determine, then you can rely on intrinsic
03:19:00 21 value, and intrinsic value may differ in different cases.
03:19:03 22 But in cases where the market value is difficult to
03:19:07 23 determine, that doesn't mean that people should be free to
03:19:10 24 commit fraud with impunity and not be subjected to a damages
03:19:15 25 award. So there is this alternative measure.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:19:18 1 Now, Mr. Martens mentioned that there are some
03:19:21 2 cases that calculate intrinsic value from the ground up
03:19:25 3 through costs. Well, we tried to do that. We requested
03:19:29 4 cost information in discovery, and in fact we specifically
03:19:31 5 said -- for example, we said: Okay. We want to know the
03:19:35 6 cost of term insurance and we want to know the cost of
03:19:39 7 riders, and we want to build this product from the ground up
03:19:41 8 to see how much all these costs are to approach
03:19:45 9 alternatively the damages valuation that way, too. They
03:19:48 10 objected. Their objection was sustained.

03:19:51 11 In the Court's order, the Court laid out two ways
03:19:53 12 for us to try to establish damages. One was a
03:19:53 13 willingness-to-pay measure, which we have adopted because
03:19:59 14 it's an entire -- Dr. Brockett's analysis is entirely from
03:20:02 15 the demand side, as the Court instructed. The Court also
03:20:06 16 laid out an intrinsic value approach. We have done that,
03:20:10 17 too. I think they can't be coming in at this time and
03:20:13 18 saying, well, you should have done it based on costs,
03:20:17 19 building the product from the ground up, when they refused
03:20:19 20 to give us that discovery. And their position was
03:20:23 21 sustained.

03:20:23 22 So I would be happy to address any other issues.

03:20:28 23 THE COURT: No. Thank you.

03:20:29 24 Briefly, Mr. Martens.

03:20:35 25 MR. MARTENS: Your Honor, with regard to the lapse

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03:20:36 1 rates and the sample of the 105, I defy Mr. Brosnahan to
03:20:41 2 point the Court to the evidence he must present to carry his
03:20:46 3 burden of proof that that 105 can show the lapse rates for
03:20:50 4 the class as a whole.

03:20:52 5 They have to put forward testimony. Dr. Brockett
03:20:57 6 had to affirmatively testify that that could be extrapolated
03:21:00 7 to a reasonable degree of statistical certainty. That
03:21:05 8 testimony does not exist. He did not testify that the 105
03:21:09 9 is a random sample. He did not testify that that 105 could
03:21:12 10 be extrapolated to the universe to a reasonable degree of
03:21:16 11 statistical certainty.

03:21:17 12 That's why I objected to that 59.8 percent coming
03:21:21 13 in, because it's going to be abused. The argument is going
03:21:23 14 to be made that applies classwide, and there is no evidence
03:21:26 15 of that. It's their burden.

03:21:29 16 This isn't just a matter of my crafty questioning
03:21:33 17 of Dr. Brockett. He never affirmatively testified to it.
03:21:37 18 They never asked him during his direct examination: Can
03:21:37 19 that lapse rate be extrapolated? It doesn't exist. That
03:21:42 20 evidence does not exist.

03:21:44 21 THE COURT: Well, Mr. Brosnahan seemed to suggest
03:21:46 22 that Dr. Brockett did not testify that he could not
03:21:51 23 extrapolate. The way I remember the testimony is he was
03:21:55 24 asked that question square on, and he said he couldn't
03:22:00 25 extrapolate it. Mr. Brosnahan took issue with that.

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03:22:07 1 MR. MARTENS: Right. So I'm saying let's say
03:22:07 2 that -- I remember my questioning the way the Court does.
03:22:08 3 Sorry, I don't mean to point to the Court with my pen. I
03:22:09 4 remember the question the way the Court does, which is I
03:22:09 5 asked him can you extrapolate it, and he said no.

03:22:12 6 But let's assume I'm wrong. Let's assume I never
03:22:15 7 asked that and that that question never came in. I still
03:22:19 8 should prevail because it's not my burden to get him to nail
03:22:22 9 it down. It's their burden to get him to put up that
03:22:26 10 evidence. I think that this 59.8 percent in particular
03:22:28 11 would be egregious for this theory to go forward, because
03:22:34 12 it's going to be distorted.

03:22:37 13 The jury are not mathematicians, and the jury was
03:22:39 14 never told in their case with their burden of proof under
03:22:44 15 their questioning: Dr. Brockett, can you to a reasonable
03:22:47 16 degree of statistical certainty extrapolate the lapse rates
03:22:50 17 for the 105 to the class as a whole? Answer: We don't have
03:22:53 18 the answer.

03:22:54 19 That question was never put to him. None of the
03:22:57 20 underlying questions that make it up such as whether the 105
03:23:02 21 was a sufficient sample size, whether it was random, any of
03:23:04 22 those things. They did not carry the burden of proof on
03:23:08 23 that, so there is no classwide proof on lapse rates. So I
03:23:12 24 think that that is critical on that issue. That's the one
03:23:17 25 point I wanted to make in rebuttal with regard to the

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03:23:21 1 Rule 23.

03:23:23 2 I have additional arguments on the Rule 50 if the
03:23:25 3 Court would like to hear them.

03:23:26 4 THE COURT: We will get to those in a minute.

03:23:27 5 MR. MARTENS: Okay.

03:23:30 6 MR. BROSNAN: Would you like me to respond?

03:23:32 7 THE COURT: No.

03:23:35 8 I'm not going to decertify the class at this
03:23:40 9 point. I think there are some sharp methodological
03:23:43 10 disputes, but it seems to me that if we go to a macro level,
03:23:49 11 there are defects that have been asserted. There's some
03:23:52 12 evidence that's been offered for those defects, and there is
03:23:56 13 evidence that those defects weren't disclosed.

03:23:59 14 If the jury finds they're material, then there was
03:24:03 15 a fraudulent disclosure. If you come down from a macro
03:24:08 16 level, there are all kinds of methodological disputes and
03:24:11 17 what not, but I believe that a macro level analysis is
03:24:13 18 sufficient at least for the time being to allow this to
03:24:22 19 proceed to the jury as a class action.

03:24:25 20 With regard to the 50(a) motion, much of it
03:24:25 21 overlaps, as Mr. Martens pointed out, with the class
03:24:27 22 certification issue. I have read your brief, and I think I
03:24:30 23 would only like to have argument on the punitive damages
03:24:35 24 issue.

03:24:35 25 So why don't we take about ten minutes and come

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03:24:38 1 back and do that.

03:24:40 2 (Recess taken at 3:24 p.m.;

03:24:40 3 proceeding resumed at 3:32 p.m.)

03:32:16 4 THE COURT: Mr. Martens.

03:32:34 5 MR. MARTENS: As I indicated previously, I will
03:32:50 6 incorporate my arguments in the motion and then I will focus
03:32:52 7 on what the Court asked, which is on the punitive damages
03:32:56 8 award.

03:32:56 9 I think on the punitive damages award, California
03:32:57 10 case law is clear and particularly California cases have
03:33:02 11 looked to the instruction to explain that the jury must be
03:33:04 12 able to consider the financial condition -- and that's the
03:33:08 13 language, the financial condition -- of the company because
03:33:11 14 what the jury is not allowed to do is simply impose
03:33:15 15 something that would be ruinous. And that's what the Court
03:33:19 16 distinguishes. The case law distinguishes between something
03:33:21 17 that would hurt and something that would be ruinous.

03:33:24 18 So they have to have in order to capably conduct
03:33:29 19 that analysis, they must have a statement of the financial
03:33:33 20 condition of the defendant. The case law is clear not only
03:33:36 21 in the case I cited this morning, the Murakami case, but
03:33:44 22 also in Lockyer vs. R.J. Reynolds Tobacco --

03:33:49 23 THE COURT: I don't think it could be seriously
03:33:49 24 argued that the plaintiff has the burden without regard to
03:33:52 25 what the defendant does to prove the financial condition.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:33:56 1 They need to prove the financial condition is fatal to an
03:33:59 2 award of punitive damages. I think that is a given in the
03:34:02 3 case law.

03:34:05 4 MR. MARTENS: I think that's right, Your Honor.
03:34:05 5 The Court had made clear, for example, in Tomaselli versus
03:34:08 6 Transamerica that you can't look to the parent, that you
03:34:10 7 have to look to the particular company that is the
03:34:13 8 defendant. The jury has to be able to answer the question:
03:34:16 9 Will that corporation be ruined by this award?

03:34:20 10 The problem that we have here is frankly the exact
03:34:23 11 same program as in Tomaselli versus Transamerica. There is
03:34:26 12 no evidence of LSW's financial condition. There is not one
03:34:33 13 scintilla of evidence in the record on this. The plaintiffs
03:34:37 14 never filed a motion to compel.

03:34:39 15 Regardless of that, we are where we are, and at
03:34:42 16 the end of the case there is not one scintilla of evidence.
03:34:46 17 We don't know what LSW's assets are; we don't know what
03:34:49 18 their liabilities are; we don't know what their reserves
03:34:51 19 are; we don't know what their net income is. We don't have
03:34:54 20 a statement of cash flows. We don't have annual revenue.
03:34:57 21 We don't have annual income.

03:35:00 22 We have nothing in this record about LSW's
03:35:05 23 financial condition. There is simply no basis for the jury
03:35:09 24 to make the necessary analysis to conduct it. The Court
03:35:13 25 will be instructing them to consider LSW's financial

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:35:15 1 condition, and they will have no evidence of that.

03:35:19 2 I think as a matter of law, we cannot send the
03:35:21 3 case to the jury asking them to do an analysis that there is
03:35:26 4 no evidence on. I don't have anything to argue. Frankly
03:35:31 5 Mr. Brosnahan has nothing to argue. He can't argue as he
03:35:35 6 would need to, and this is the critical point. He would
03:35:37 7 need to argue they can absorb this amount, that LSW can
03:35:42 8 absorb what he asked for \$129 million punitive damages
03:35:45 9 award. The jury would have no way to evaluate whether
03:35:49 10 that's true or not. There is just no evidence on that.

03:35:53 11 So on that failure of proof, I think California
03:35:55 12 law is crystal clear. It's the plaintiff's burden to put in
03:36:01 13 evidence of our financial condition. There is not a single
03:36:04 14 financial statement specific to LSW.

03:36:06 15 So for that reason, I think the jury cannot be
03:36:07 16 provided with an opportunity to simply, what the California
03:36:10 17 Courts have said, speculate. That's all they would be
03:36:13 18 doing. They would literally be guessing as to whether or
03:36:16 19 not LSW could afford \$129 million or something less or
03:36:22 20 something more.

03:36:23 21 For that reason, I believe that claim cannot go to
03:36:26 22 the jury. Thank you.

03:36:27 23 THE COURT: Mr. Brosnahan.

03:36:28 24 MR. BROSNAHAN: Thank you, Your Honor.

03:36:28 25 THE COURT: You would agree if the record only

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03:36:31 1 contained the National balance sheet, financial statement,
03:36:36 2 that you wouldn't have a basis for punitive damages?

03:36:39 3 MR. BROSNAHAN: The only quibble I have with that,
03:36:41 4 Your Honor, is that in this case we sought the discovery.
03:36:45 5 They refused to give it. They said they don't keep their
03:36:50 6 numbers that way.

03:36:53 7 THE COURT: But doesn't Tomaselli foreclose that
03:36:55 8 argument, focusing on the public policy nature of an award
03:36:59 9 of punitive damages? The award is made for the protection
03:37:04 10 of the public. It's simply happenstance that the dollars go
03:37:06 11 to the plaintiffs.

03:37:08 12 MR. BROSNAHAN: That's true, Your Honor. I
03:37:09 13 confess I have not had a chance to read the Tomaselli case.
03:37:13 14 I got this brief this morning. It doesn't even cite the
03:37:18 15 Tomaselli case.

03:37:20 16 THE COURT: It just cites Adams.

03:37:23 17 MR. BROSNAHAN: Yes. And I did have a chance to
03:37:23 18 read Adams during a break. It was in Adams they said it
03:37:25 19 will not happen due to inaction. The defendant in that case
03:37:31 20 apparently failed to object to the fact that no evidence of
03:37:34 21 financial condition was put in. And I think it says in
03:37:40 22 footnote 5, which I believe was the footnote cited, that
03:37:43 23 punitive damages will not be allowed due to inaction, I
03:37:47 24 think is the phrase.

03:37:48 25 THE COURT: Right.

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:37:49 1 MR. BROSNAHAN: Which I think is different from
03:37:51 2 what we have here. Here we have consolidated financials,
03:37:55 3 and from what they've told us, they just don't keep track of
03:37:59 4 it separately, and so they were unwilling to give it to us
03:38:04 5 separately. They told us, well --

03:38:05 6 THE COURT: Isn't that contrary to testimony that
03:38:07 7 you elicited from --

03:38:12 8 MR. BROSNAHAN: I got a rough estimate of at least
03:38:16 9 20 percent of the business was LSW. Mr. DeSantos testified
03:38:21 10 that California was one of their largest markets. There was
03:38:27 11 some very general testimony. In Ms. MacGowan's deposition I
03:38:28 12 asked her how much of the business was California, and she
03:38:31 13 said she couldn't tell me at all.

03:38:33 14 THE COURT: But in your examination of
03:38:37 15 Mr. DeSantos at page 151 and 152:

03:38:42 16 "Q Do you know what LSW's revenues were for
03:38:46 17 last year?

03:38:46 18 "A I do not.

03:38:52 19 "Q Is that reported, LSW's revenues?

03:38:53 20 "A I don't know.

03:38:53 21 "Q But there would be documents that
03:38:55 22 recount LSW's revenues?

03:38:58 23 "A Yes, there would be documents."

03:38:59 24 MR. BROSNAHAN: They refused to produce them. So
03:39:02 25 unless the standard is that we have to make a motion to

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03:39:06 1 compel and lose on every single thing -- and I don't think
03:39:10 2 that is the standard --

03:39:12 3 THE COURT: You made the judgment not to make a
03:39:15 4 motion to compel based on being pointed toward the web page
03:39:19 5 where the financials for National appear and the assumption
03:39:24 6 that you would get some kind of breakout from them as to
03:39:28 7 what portion was attributable to LSW, but you never got that
03:39:32 8 follow-on data; did you?

03:39:35 9 MR. BROSNAHAN: We did not get the follow-on data
03:39:37 10 other than the data that we have elicited in the trial,
03:39:41 11 admittedly not very specific data.

03:39:44 12 THE COURT: Is there any data on the assets of
03:39:47 13 LSW?

03:39:48 14 MR. BROSNAHAN: Specific assets, no.

03:39:49 15 THE COURT: Assets in general?

03:39:51 16 MR. BROSNAHAN: Well, other than as may be
03:39:52 17 inferred from their contribution to the size of the
03:39:55 18 business. We do have data on the profitability --

03:39:59 19 THE COURT: But we have no direct evidence of
03:40:01 20 their assets; correct?

03:40:02 21 MR. BROSNAHAN: No direct evidence.

03:40:03 22 THE COURT: We have no direct evidence of their
03:40:06 23 liabilities; correct?

03:40:07 24 MR. BROSNAHAN: That's correct.

03:40:10 25 THE COURT: Okay. Wouldn't those two factors be

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03:40:12 1 significant in making an assessment of a business entity's
03:40:17 2 financial condition?

03:40:19 3 MR. BROSNAHAN: Those factors would be
03:40:21 4 significant. On the other hand, if we limit our prayer as
03:40:27 5 we have, I think a reasonable inference can be drawn that
03:40:32 6 it's not significant in the scheme of the overall size of
03:40:37 7 the business. We do have data on the size of the Paragon
03:40:40 8 and Provider businesses.

03:40:43 9 THE COURT: But would you not agree it would make
03:40:49 10 a difference as to whether there is 100 million in assets or
03:40:53 11 1 million in assets for LSW in assessing its financial
03:40:58 12 condition?

03:40:58 13 MR. BROSNAHAN: Yes, I would agree, Your Honor.

03:40:59 14 THE COURT: Wouldn't you agree that it would be
03:41:01 15 significant to look at the liability side and to see what
03:41:05 16 the shareholder equity number is?

03:41:11 17 MR. BROSNAHAN: Yes, Your Honor. I would agree.

03:41:13 18 THE COURT: And wouldn't the analysis be different
03:41:16 19 of the financial condition if the shareholder equity number
03:41:21 20 were 1 million plus or 1 million minus?

03:41:25 21 MR. BROSNAHAN: Yes, Your Honor, although I do
03:41:26 22 think again we have to look to LSW's conduct not just in
03:41:32 23 failing to produce discovery but in objecting to questions
03:41:36 24 having anything to do with separation of corporate form.
03:41:40 25 When they were putting on their witnesses, it was all one

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:41:43 1 happy family --

03:41:46 2 THE COURT: But Tomaselli makes the point, I
03:41:48 3 think, quite nicely. On appeal the plaintiff argued that it
03:41:54 4 should be analyzed under an alter ego theory. The Court
03:41:58 5 rejected that out of hand because it wasn't litigated. It
03:42:01 6 wasn't litigated here either.

03:42:05 7 MR. BROSNAHAN: Normally it's the plaintiff who is
03:42:07 8 trying to litigate an alter ego theory. They essentially
03:42:13 9 litigated an alter ego defense, telling the jury that LSW
03:42:13 10 was a mutual company. They litigated an alter ego defense
03:42:19 11 here. So I think that makes it very different.

03:42:21 12 THE COURT: Okay.

03:42:21 13 MR. BROSNAHAN: I have nothing further, Your
03:42:22 14 Honor.

03:42:24 15 THE COURT: Well --

03:42:28 16 MR. BROSNAHAN: We would appreciate an opportunity
03:42:30 17 to look at the cases since we have not had an opportunity to
03:42:33 18 do that.

03:42:36 19 THE COURT: I'm going to grant the 50(a) motion as
03:42:38 20 to the punitive damage claim.

03:42:41 21 When I shared my preliminary thoughts this
03:42:43 22 morning, I gave some weight to the fact that discovery
03:42:51 23 relative to punitive damages was sought and resisted by
03:42:55 24 pointing the plaintiffs to the National Life website. I
03:43:03 25 think in the final analysis, it's error to give any weight

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:43:08 1 to those set of facts because they do not diminish the
03:43:12 2 burden of the plaintiff under Adams to make an affirmative
03:43:16 3 showing of the financial condition of the defendant.

03:43:19 4 Tomaselli is found at 25 Cal.App. 4th at 1269, and
03:43:26 5 at 1282 the Court observes: Our review of that recent
03:43:37 6 authority, meaning Adams, convinces that this is a
03:43:40 7 requirement imposed as a matter of public policy and hence
03:43:43 8 not subject to waiver by failure of an intended defendant to
03:43:49 9 object or otherwise call attention to the inadequacy of the
03:43:53 10 proof.

03:43:59 11 The Court goes on to discuss Adams further at
03:44:09 12 1283: The rationale of the Adams Court concerning the
03:44:15 13 purpose of punitive damages leads us to conclude that a
03:44:17 14 private litigant's error or omission such as a failure to
03:44:23 15 object to irrelevant evidence cannot obviate the public's
03:44:25 16 interest in meaningful judicial oversight of punitive damage
03:44:30 17 awards. Adams explained that the function of punitive
03:44:35 18 damages is a purely public one -- and public is in italics
03:44:38 19 -- to punish wrongdoing and thereby protect itself from
03:44:45 20 future misconduct.

03:44:49 21 I reaffirm my view that I cannot give any weight
03:44:53 22 to the fact that plaintiffs may have been thrown off the
03:44:56 23 track in the fact that LSW pointed to the National web page
03:45:01 24 and the National financials. Nevertheless, in terms of the
03:45:05 25 public policy aspect and the purpose of punitive damages,

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:45:08 1 that does not vitiate the obligation of the plaintiff in the
03:45:14 2 first instance to establish the financial condition of the
03:45:17 3 defendant.

03:45:18 4 We have two snippets in the record which I find
03:45:22 5 insufficient even when joined with the National financial
03:45:26 6 statements in Exhibit 557 to give the jury a sufficient set
03:45:32 7 of facts to make a reasonable determination of LSW's
03:45:36 8 financial condition.

03:45:43 9 In Mr. DeSantos's testimony, he is asked at page
03:45:47 10 151:

03:45:49 11 "Q Okay. So why don't you speak of the
03:45:54 12 life insurance product line.

03:45:55 13 "A I believe that we sold north of 150 of
03:45:58 14 what we call rated premium across all product
03:46:01 15 lines, referring to National.

03:46:04 16 "Q What share of those revenues stems from
03:46:08 17 California?

03:46:09 18 "A I don't know the exact share.

03:46:12 19 "Q Isn't it fair that California is about
03:46:16 20 20 percent of the LSW business?

03:46:19 21 "A I know it's one of our larger markets,
03:46:22 22 yes."

03:46:23 23 THE COURT: It goes on a little bit further:

03:46:26 24 "Q Do you know what LSW's revenues were
03:46:30 25 last year?

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03:46:31 1 "A I do not.

03:46:32 2 "Q Is that reported, LSW's revenue for the
03:46:38 3 life business?

03:46:39 4 "A I don't know.

03:46:39 5 "Q But there would be documents that
03:46:45 6 recount LSW's revenues?

03:46:47 7 "A Yes."

03:46:47 8 I believe I read that passage previously and
03:46:50 9 attributed it to Ms. MacGowan incorrectly. It should be to
03:46:53 10 Mr. DeSantos.

03:46:57 11 If we turn to Ms. MacGowan's testimony, there is
03:46:59 12 also a snippet in the April 22 volume at page 124:

03:47:05 13 "Q But National Life Insurance Company owns
03:47:14 14 LSW; right?

03:47:16 15 "A It does.

03:47:18 16 "Q Okay. And approximately what are the
03:47:19 17 profits of LSW on an annual basis?

03:47:22 18 "A I don't know.

03:47:25 19 "Q No idea?

03:47:26 20 "A No. We look at what is reported to us
03:47:34 21 at the employee level. What is reported to us at
03:47:35 22 the employee level is the overall company profits,
03:47:38 23 which include the life and annuity and both
03:47:41 24 companies combined."

03:47:42 25 "Q And is LSW's contribution of that profit

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03:47:46 1 ten percent, 20 percent?

03:47:47 2 "A I think it's more than either of those
03:47:49 3 two numbers, but I don't know how much.

03:47:52 4 "Q Somewhere north of 20 percent?

03:47:54 5 "A Yes.

03:47:55 6 "Q Of the National Life Group companies?

03:48:00 7 "A I think so."

03:48:04 8 Assuming that there is a basis to infer that
03:48:06 9 20 percent of the profits of the insurance business, of
03:48:10 10 National's insurance business, come from LSW, I believe that
03:48:16 11 that is insufficient to provide the jury a reasonable basis
03:48:20 12 to assess the financial condition of LSW.

03:48:28 13 It would make a difference without regard to what
03:48:30 14 the revenues or profits are as to what the assets and
03:48:37 15 liabilities are, particularly I would focus on the
03:48:43 16 shareholders' equity, which is really a balancing of the
03:48:50 17 assets that are in excess of liabilities drops down to your
03:48:54 18 shareholder equity.

03:48:57 19 As I suggested in my hypothetical in understanding
03:49:00 20 what is an appropriate number to punish but not to eliminate
03:49:04 21 from the marketplace, it would be critical to know what the
03:49:07 22 assets and liabilities are, what the relative relationship
03:49:10 23 between the two is. And I think the best barometer of that
03:49:13 24 for a jury determination of financial condition is the
03:49:17 25 shareholder equity number. We have none of that in the

SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

03:49:21 1 record.

03:49:22 2 I find that profits alone, even if Ms. MacGowan's
03:49:31 3 testimony is credited fully, and I think there are enough
03:49:34 4 caveats to question the worth of her testimony, to question
03:49:36 5 the basis for her testimony -- worth is not a good word --
03:49:36 6 but to question the ten to 20 percent figure, that still
03:49:53 7 doesn't tell you what the overall financial condition is and
03:49:56 8 it doesn't serve as a surrogate for knowing what the assets
03:49:59 9 and liabilities are.

03:50:02 10 Similarly, revenues don't tell you enough to
03:50:07 11 assess the financial condition. The company may have large
03:50:12 12 revenues but little or no profit. A company may have large
03:50:19 13 revenues but a very small profit margin.

03:50:23 14 Compare the typical profit margin at a grocery
03:50:31 15 store to a business that has high markups. A grocery store
03:50:36 16 typically has about a one-percent-of-revenue profit. Other
03:50:41 17 businesses are much more. Therefore, the revenues don't
03:50:44 18 tell you much unless you know what the profitability is.

03:50:48 19 All we have before us is the National financial
03:50:54 20 statement prepared by Price Waterhouse. I think what the
03:50:58 21 Court in Tomaselli said about the inadequacy of a similar
03:51:03 22 piece of data for the parent corporation in that case is
03:51:07 23 true here.

03:51:10 24 The Court analyzed the facts. This annual
03:51:13 25 report -- at 1283: This annual report is a consolidated

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03:51:19 1 financial statement for the parent company and all of its
03:51:22 2 many subsidiaries. However, the annual report contains no
03:51:24 3 separate information on appellant's financial status.
03:51:26 4 Instead, the annual report was for the parent company and
03:51:30 5 encompassed the assets, revenues, and profits from a host of
03:51:33 6 businesses such as consumer lending, commercial lending,
03:51:43 7 leasing, real estate services, investment management, life
03:51:47 8 insurance, et cetera, which are wholly unrelated to
03:51:50 9 appellant's business. The only part of the annual report
03:51:54 10 even remotely germane was a section summarizing the
03:51:58 11 financial status of something described as the Transamerica
03:52:00 12 Insurance Group.

03:52:03 13 I think the same could be said of Exhibit 557
03:52:07 14 where the revenues are broken out in a similar number of
03:52:14 15 disparate categories. 557 at page 3, insurance premiums,
03:52:20 16 policy and contract charges, net investment income, net
03:52:23 17 realized investment gain, losses, change in value of trading
03:52:27 18 equities, mutual fund commissions and fees, other income.
03:52:32 19 The same melange of revenue sources that was illustrated in
03:52:37 20 Tomaselli has its parallel at page 3 of Exhibit 557.

03:52:43 21 For all the foregoing reasons, I find that no
03:52:48 22 reasonable jury could come to a conclusion as to what the
03:52:50 23 financial condition of LSW is. Absent an affirmative
03:52:55 24 showing of what the financial condition is, Adams vs.
03:52:56 25 Murakami makes clear that there is a failure of proof on

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03:53:00 1 punitive damages. Accordingly, the Rule 50(a) motion is
03:53:06 2 granted as to the punitive damage claim.

03:53:14 3 Okay. Anything else before we turn to the
03:53:16 4 instructions?

03:53:17 5 MR. BROSNAHAN: I think nothing else before we
03:53:19 6 turn to the instructions.

03:53:24 7 THE COURT: Okay. Then why don't we all gather up
03:53:24 8 and head to the jury room.

03:53:24 9 (Proceeding adjourned at 3:53 p.m.)

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SHARON SEFFENS, U.S. DISTRICT COURT REPORTER

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CERTIFICATE

I hereby certify that pursuant to Section 753,
Title 28, United States Code, the foregoing is a true and
correct transcript of the stenographically reported
proceedings held in the above-entitled matter and that the
transcript page format is in conformance with the
regulations of the Judicial Conference of the United States.

Date: April 25, 2014

/s/ Sharon A. Seffens 4/25/14

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