Alert

July 13, 2023

COZEN O'CONNOR

The Latest McHugh Battleground: Class Certification

We are writing with a further litigation update on the potential after-effects of the California Supreme Court's pivotal decision in *McHugh v. Protective Life Insurance Company*.[1] That decision addressed the breadth of the application of California Insurance Code sections 10113.71 and 10113.72, which extended life insurance policy grace periods to 60 days and mandated that insurers notify policyholders annually of their new right to designate a person to receive notice of lapse or termination of a policy for failure to pay premiums. Of particular importance, the *McHugh* court did not limit those requirements only to policies issued or delivered *after* the effective date of those statutory sections, January 1, 2013, but also extended them to **policies already in force on that date**. When the decision came down, it threatened the life insurance industry with significant liability. Since it was issued, plaintiffs' lawyers have, predictably, filed dozens of proposed class actions trying to impose such liability.

At the time of our last alert, the only significant decisions on class certification were *Siino v. Foresters Life Ins. & Annuity Co.*,[2] and *Bentley v. United of Omaha Life Ins. Co.*[3] However, both were limited in their scope. In *Siino*, as we previously reported, the court denied the plaintiff's motion for class certification because the plaintiff could not produce a cognizable class-wide damages model to meet the predominance requirement. The case did not, however, touch on more substantive legal issues. *Bentley* is of limited significance because it concerned a class that was carefully screened for class members who could have intentionally lapsed their policies, and thus the class totaled only 43 members. Indeed, a further 10 members were excluded, and the court approved the final class settlement on July 29, 2022, with a total judgment of only $2,427,791.22.

Over the past year, we have seen several more substantive decisions on class certification. In these decisions, a pattern may be starting to emerge as to issues that defendant-insurers can use to their advantage, including:

1. satisfaction of the statutory sections' procedural requirements for at least some policies within the proposed class,
2. differences in the application of the statutory sections' requirements between policies with living insureds and those with deceased insureds, and
3. identification of, or screening for, intentionally lapsed policies.

First, in *Moriarty v. Am. Gen. Life Ins. Co.*,[4] the court denied plaintiff's motion for class certification. This case dealt with a named plaintiff insured with a $1 million term policy that lapsed, and thereafter the insured died. The court held that the insurer complied with the grace requirement but did not comply with the designation requirement (to allow the insured to designate a recipient for notices) or the lapse notice requirement because it was not mailed to a designee. In denying the plaintiff's related motion for summary judgment on breach of contract, the court held that *McHugh* did not clearly dispose of the issues of proximate cause and actual notice. On class certification, the court held that under Fed. R. Civ. P. 23(a), the plaintiff's claim for death benefits is "fundamentally different" from the equitable relief other class members would be seeking for policy reinstatement. Moreover, under Fed. R. Civ. P. 23(b)(3), the court held that "[i]t would be misguided to certify a damages class where most class members have no damages," noting that the proposed class would include those who have lapsed but not yet terminated or those who have long known that their policies were terminated. The court also voiced "substantial concerns as to whether the issues of the individual claims such as actual damages and causation would predominate."

Second, in *Pitt v. Metro. Tower Life Ins. Co.*,[5] the court also denied class certification. The named plaintiff pursued a claim for death benefits on a policy that lapsed in 2016. The insurer, Tower,

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adequately demonstrated that it may have satisfied statutory requirements on at least some policies included in the class. The court, therefore, determined that typicality, predominance, and superiority could not be satisfied because "there is a lack of common evidence as to Tower's compliance with the Statutes, requiring individualized inquiries regarding the terms of each class policy and the timing of the notices Tower provided." The court also questioned the propriety of the named plaintiff representing 97% of policies where insureds were still living, and damages would likely require an individualized analysis. The court also denied certification to decide legal issues under Rule 23(b)(2), which provides for declaratory and injunctive relief under less rigorous standards, or Rule 23(c)(4), which arguably allows for so-called "issue classes" to decide only certain issues on a class-wide basis to materially advance the litigation.

Third, in *Nieves v. United of Omaha, Life Ins. Co.*,[6] the court also denied class certification. The case involved a unique fact pattern for the named plaintiff. The policy was actually in-force with a living insured after the insurer proactively allowed reinstatement following its own error in processing a new bank authorization. These circumstances led the court to conclude that the plaintiff was atypical of the class. However, the court also decided more broadly that typicality and predominance could not be met "because Plaintiff's claims will require individualized analysis of the terms of each class member's policy, United's compliance with the Statutes with respect to each class member's policy, and each class member's various defenses." United, the insurer, had adequately shown that it sent designation notices and granted extended grace periods on at least some policies. United also offered an expert who sampled 100 policies and found that 85 had circumstantial evidence that the policyowners intentionally lapsed. This demonstrated that the issue of damages would be an individualized issue of fact. The court also denied certification under Rule 23(c)(4).

Fourth, the court granted class certification in *Farley v. Lincoln Benefit Life Co.*[7] The named plaintiff's policy involved a living insured, and the insurer argued that the plaintiff could not represent those with potential death benefit claims. The court, however, determined that all class members suffered the same procedural harm. The insurer also attempted to argue that the plaintiff could not or did not screen for intentionally lapsed policies. The court dismissed this argument with the observation that intentional lapse would be captured by excluding policies that were affirmatively surrendered.[8] The court did, however, certify only a Rule 23(b)(2) class for declaratory and injunctive relief, finding that the plaintiff could not adequately represent those with potential death benefit claims. The plaintiff had disclaimed monetary damages, and those with potential death benefit claims could only benefit from such relief. The defendants have appealed.

Fifth, in *Small v. Allianz Life Ins. Co. of N. Am.*,[9] like in *Farley*, the court **granted** class certification, but under **both** Rule 23(b)(2) and (b)(3). The court divided the case into two sub-classes involving living and dead insureds, which determines the availability of declaratory relief. The court dismissed concerns that the plaintiff only had a claim for death benefits because the insured has died and thus would not be typical of the 94% of members' claims, which involve living insureds. The court found that the plaintiff's claims needed only to be "reasonably co-extensive." The court also rejected the insurer's attempts to highlight variations in its notification practices and to show through sampling that many insureds knowingly allowed their policies to lapse. Instead, the court focused on the general issue of the insurer's compliance with the statutes to satisfy commonality and predominance.

Finally, in *Steen v. Am. Nat'l Ins. Co.*,[10] the court distinguished *Farley* and denied class certification. The court found typicality not satisfied when the class definition included the failure to provide one or more of four potential statutory notices, which presented too much potential variety among class members. The court detected in the plaintiffs' briefing that they may have received some of the required notices. The defendant had also proved that the named plaintiffs intended their policies to lapse and would not pay back premiums if asked to do so. The court found these facts to defeat any showing of causation for plaintiffs' breach of contract claims and the appropriateness for declaratory relief, thus further defeating typicality. The court also questioned the inclusion of insureds who affirmatively canceled their policies. In addition, the court found classification inappropriate under Rule 23(b)(2) and (b)(3). Subsection (b)(2) did not apply because of the inclusion of policies potentially due death benefits and members who claim only money damages. Subsection (b)(3) did not apply for many of the reasons already discussed. Notably,

however, the court opined that it appeared to be undisputed that the defendant did not provide an opportunity to designate a third party for receipt of notifications until 2021 and that this could potentially be the basis for a certification argument. The court also provided other guidance for a more discrete class definition.

As seen above, *Farley* and *Small* break with the consensus that seemed to be emerging. *Steen* is more helpful for defendants. This means that both plaintiffs and defendants will look to the Ninth Circuit for further guidance. Defendants will wish for the Ninth Circuit to close the door on certification and endorse a more skeptical approach than taken by *Small,* while plaintiffs will try to convince the Ninth Circuit to override the district court consensus. In the meantime, class certification decisions in the district courts will continue. Next will likely be *Kelley v. Colonial Penn Life Ins. Co*.[11] There, the insurer has continued the strategy to attack the question of intentional lapse and has employed a survey of proposed class members that purports to show only 1.8% of members lapsed because "they forgot to pay."[12]

As for plaintiffs, they likely pursued broad class definitions buoyed by the allegedly clear decisions in their favor in *McHugh* and *Thomas v. State Farm Life Insurance Company*,[13] (holding that "[a]n insurer's failure to comply with these statutory requirements means that the policy cannot lapse"). With these losses on class certification, especially before *Small*, plaintiffs have moved to reposition their cases to involve more limited classes. (*See, e.g.*, *Phan v. Transamerica Premier Life Ins. Co.*,[14] finding that the plaintiff's attempt to reduce the class to only death benefit claims was improper by way of reply in support of its original motion for class certification and denying such motion without prejudice).

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[1] 12 Cal. 5th 213, 243, 494 P.3d 24, 43 (2021)

[2] 340 F.R.D. 157 (N.D. Cal. 2022)

[3] No. CV157870DMGAJWX, 2018 WL 3357458 (C.D. Cal. May 1, 2018)

[4] No. 3:17-CV-1709-BTM-WVG, 2022 WL 6584150 (S.D. Cal. Sept. 27, 2022)

[5] No. 20-CV-694-RSH-DEB, 2022 WL 17972167 (S.D. Cal. Dec. 1, 2022)

[6] No. 21-CV-01415-H-KSC, 2023 WL 2705836 (S.D. Cal. Mar. 28, 2023)

[7] No. 2:20-CV-02485-KJM-DB, 2023 WL 3007413 (E.D. Cal. Apr. 18, 2023)

[8] This observation is admittedly inaccurate. Under many scenarios involving nonpayment, the policy may not have any surrender value, and a policyholder would therefore prefer to allow the policy to lapse, which involves no effort.

[9] No. CV2001944TJHKESX, 2023 WL 4042593 (C.D. Cal. May 23, 2023)

[10] No. 220CV11226ODWSKX, 2023 WL 4004192 (C.D. Cal. June 14, 2023)

[11] No. 220CV03348FLAEX (C.D. Cal.)

[12] ECF 58, at p.6.

[13] No. 20-55231, 2021 WL 4596286 (9th Cir. Oct. 6, 2021) (unpub.)

[14] No. 20-CV-03665-BLF, 2023 WL 3468313 (N.D. Cal. Apr. 17, 2023)