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LEGAL ISSUES AND DEVELOPMENTS
FROM CARLTON FIELDS JORDEN BURT

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JORDEN BURT

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ONLINE HEALTH CARE: NOT SO FAST

Telemedicine Hits A Few Speed Bumps

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NEWS & NOTES

Risky Business: Common Cyber Security Risks, Expensive Consequences

BY ELIZABETH M. BOHN & MATTHEW E. KOHEN

Large-scale data breaches have become increasingly common, bringing with them not only bad press and loss of customer goodwill, but serious monetary risk. New cyber security legislation enacted in multiple states, including Connecticut, Montana, and New Jersey, has also increased regulatory scrutiny and risk. Key causes of data breach risk and liability include:

1. **Inadequate training and employee negligence.** Employees with access to sensitive data who are not adequately trained to identify spoofed websites, phishing emails, or other security risks, may jeopardize their secure credentials, in turn putting sensitive company data at risk. Anthem and Premera Blue Cross, both of which sustained large scale data breaches earlier this year, are believed to have fallen victim to a hybrid spoof-phishing attack called typosquatting, perpetrated by creating and associating an exact copy of an employer's website with a slightly-misspelled version of the employer's URL. A phishing email is then used to redirect employees to the decoy site, where they may unwittingly enter secure credentials. Proper training and employee awareness is essential to avoiding such attacks.

2. **Third-party service providers.** The consumer finance industry outsources certain business functions to third-party service providers. The CFPB, other regulators, and various state laws hold industry members responsible for the actions or inactions of third-party service providers, mandating review and understanding of such vendors' own data security protocols.

   Third parties with access to equipment, infrastructure, and sensitive data, such as maintenance and service companies, are also a source of risk, providing a potential alternative, less secure access point to protected data. For example, the source of the massive Target breach (which resulted in a $19 million settlement with MasterCard), is believed to have been a phishing email sent to Target's HVAC vendor. Inadequate website design can also create risk. After an Illinois bank's website, which had been designed, hosted and maintained by a third-party web developer, was hacked, the bank had to revamp the website to address the security issues, as well as notify its customers of the breach to comply with state privacy laws. In avoiding such risks, industry must assess and act to protect the security of data in the hands of service providers, guard against potential back door, unintended access through other third-party vendors, and ensure public facing websites are adequately secured.

3. **Malicious insiders.** Needless to say, threats to cyber security may also come from malicious employees. For example, AT&T was recently fined $25 million for failing to prevent the misconduct of a rogue employee which led to a data breach affecting nearly 300,000 customers. Mitigation of this risk requires thorough screening procedures during employee on-boarding, adequate training, supervision, and monitoring. In addition, screening and training policies and protocols must be regularly assessed and updated.

Needless to say, threats to cyber security may also come from malicious employees.

Ninth Circuit Finds Bonus Indexed Annuity Delivers Exactly What was Promised

BY CHRISTINE STODDARD

Observing that it "delivered precisely what it promised," the Ninth Circuit Court of Appeals recently affirmed summary judgment for an insurer in a case alleging violations of the Racketeer Influenced and Corrupt Organizations Act (RICO) and state consumer fraud laws related to its sale of annuities. In *Eller v. EquiTrust Life Insurance Co.*, the purchaser of a bonus indexed annuity brought a putative class action alleging that the insurer engaged in fraud and challenging the annuity's premium bonus, the use of a "market value adjustment," and the insurer's alleged attempt to evade state nonforfeiture laws through its application of maturity dates.

The annuities at issue used "index credits," which would increase the value of an individual's account based on changes in a market index like the S&P 500. Additionally, a market value adjustment, also based on an external index, might be applied upon the early withdrawal of funds or surrender of the annuity, resulting in a positive or negative adjustment of the account's value. Finally, the annuity included a bonus feature through which the account was credited with a bonus consisting of 10 percent of premiums paid during the first year.

The court first disposed of plaintiff's claim that the premium bonus was fraudulent, determining that "a seller generally has no duty to disclose internal pricing policies or its method for valuing what it sells." **Because the insurer owed no fiduciary or statutory duty to the plaintiff, it had no obligation to disclose that an annuity with a bonus feature might have lower index credits than alternative products.** Additionally, since the plaintiff received exactly what he was promised, the bonus was not illusory, nor had the insurance company made any affirmative misrepresentations. The court dismissed plaintiff's state law claims alleging violations of consumer fraud statutes and unjust enrichment for the same reasons.

The court further rejected plaintiff's claim that the formula for the market value adjustment, which would increase downward adjustments and decrease upward adjustments, was not properly disclosed in the marketing materials. It noted that the insurer "meticulously explain[ed]" the market value adjustment and how it was applied. The court also disagreed with plaintiff's position that the company's policy of providing relief from the annuity's fixed maturity date at an individual's request converted the annuity into one with an optional maturity date that must comply with specific provisions of the state nonforfeiture law.

Litigation Finance on the Rise—But Questions Abound

BY SHAUNDA PATTERSON-STRACHAN

Increasingly, lawyers are identifying a purportedly injured plaintiff, a theory of liability, and a defendant, and then turning to a hedge fund to finance the lawsuit, perhaps with the help of a litigation finance specialist. The investor thoroughly vets the deal and charges at least 15 to 18 percent interest on the loan, some or all of which may ultimately be passed on to the client.

Investors of many stripes, including hedge funds, banks, and individuals, are betting on consumer and commercial lawsuits, seeking a share of a potentially lucrative recovery. While the practice of making loans to support litigation has existed in the United States since the 1990s, it has evolved. 2014 saw the emergence of crowdfunding-like online marketplaces for such investments, inviting investors to create a free account, access case summaries to learn about potential investments, and "follow courtroom action."

Why the growth of litigation finance? Pointing to the high cost of litigation, advocates say it enhances access to the courts and the means to win—funding could be the difference between retaining an expert witness or not. And sophisticated financers tout their services to corporate GCs, positing that a litigation claim is an asset that can be sold, allowing the company to use the funds to grow its business. But critics wonder whether dockets have become crowded with lawsuits that would not exist absent financing.

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Disclosure regarding financing is also a concern. In federal courts, the relevant rules (such as Federal Rule of Civil Procedure 7.1) do not require disclosure. Last year, however, one of the litigation finance industry's principal critics, the U.S. Chamber of Commerce Institute for Legal Reform, urged an amendment to Rule 26(a)(1)(A) requiring that information about third-party investments in litigation be added to the list of required "initial disclosures." Many such investors, it noted, are "publicly traded companies or companies supported by investment funds whose individual shareholders may include judges or jurors."

Another concern is the viability of fundamental protections. In 2014, a federal judge in Illinois rejected a plaintiff's contention that documents provided to potential funders were protected by the attorney-client privilege because the plaintiff and investors shared no common legal interest ("[a] shared rooting interest in the 'successful outcome of a case'" is not enough). Still, the judge found documents containing counsels' mental impressions did not lose work product status when shared where the plaintiff had confidentiality agreements with the prospective funders.

Appellate Courts + STOLI = Mixed Results

BY JOHN HERRINGTON

In recent years, federal district courts addressing claims and defenses with respect to stranger-originated life insurance (STOLI) schemes have reached a variety of results. Accordingly, federal appellate courts have increasingly been called upon to resolve issues such as the interplay between various insurable interest and incontestability requirements.

The Eight Circuit Court of Appeals recently reversed the trial court ruling that a STOLI policy was *void ab initio* based on an insured's intent. In *PHL Variable Insurance Co. v. Bank of Utah,* the district court declined to not follow the majority view, holding that an insurer may challenge a policy for lack of insurable interest beyond the contestability period, based on a finding that the insured intended, from inception, to transfer the policy to a third-party with no insurable interest in the insured's life. **The Eight Circuit, further predicted that, *applying Minnesota common law,* the Minnesota Supreme Court would find that the insurable interest requirement is met when a person purchases insurance on his own life, regardless of any intent to transfer the policy.** In reaching its decision, the Eighth Circuit distinguished the substantial body of persuasive case law from other jurisdictions by noting that, unlike many other states, Minnesota did not adopt an insurable interest statute until 2009 and, in any event, that statute (Minn. Stat. §§ 60A.078 *et seq.*) was prospective and did not apply to the underlying policy which was issued in 2007.

When recently given the opportunity to consider similar issues under Florida law, the Eleventh Circuit Court of Appeals certified the questions to the Florida Supreme Court. In *Pruco Life Ins. Co. v. Wells Fargo Bank, N.A.*, the Eleventh Circuit examined two conflicting district court opinions—one following the majority position that where the underlying policy was fraudulently obtained, it was *void ab initio* from inception and the incontestability provision did not bar the insurer's challenge and the other ruling that the lack of an insurable interest renders an insurance policy merely voidable (as opposed to *void ab initio*). Noting a nationwide split and the absence of clear guidance from Florida courts, the Eleventh Circuit requested a determination from the Florida Supreme Court as to whether (1) an insurer can challenge an insurance policy as being *void ab initio* for lack of the insurable interest under Florida's insurable interest statute beyond the expiration of the two-year contestability period and (2) if so, whether Florida's insurable interest statute requires an individual with the required insurable interest to procure the insurance policy in good faith.

Thus, STOLI issues still largely turn on applicable state law—even when the challenge makes its way to federal court.

A Tale of Two Annuities: Exchange of Variable for Fixed Annuity Integral in SLUSA Dismissal

BY PAUL WILLIAMS

After attending an annuity seminar, Robert and Diane Ruud exchanged their variable annuity for a fixed annuity sold by PHL Variable. According to the Ruuds, seminar provider John Friendshuh represented the fixed annuity as superior but did not disclose his commission, causing plaintiffs financial loss due to reduction in annuity value and fee payments. The Ruuds brought a putative class action against Friendshuh and PHL for consumer fraud and deceptive trade practices under Minnesota law, consisting of all senior citizens who exchanged an annuity for a PHL annuity through Friendshuh or other PHL agents.

Defendants asserted that the state law claims were prevented by the Securities Litigation Uniform Standards Act (SLUSA), which disallows class actions alleging a misrepresentation or omission of material facts under state law "in connection with the purchase or sale of a covered security." Plaintiffs countered that the transaction was not made "in connection with… [a] covered security" because only the surrendered, variable annuity was so defined under SLUSA.

Since the surrender of a variable annuity was made "in connection with" the sale of a covered security, SLUSA preempted the class claims.

The court sided with the defendants, observing that the exchange at issue was not a single, unilateral purchase, but both a purchase and a sale. The court viewed the surrender of the variable annuity as integral to the transaction, noting that many of plaintiffs' alleged misrepresentations were tied directly to the surrender. Since the surrender of a variable annuity was made "in connection with" the sale of a covered security, SLUSA preempted the class claims.

Read broadly, this case suggests that, where an "exchange" is alleged, SLUSA is likely to impact a significant proportion of classes alleging misrepresentations under state law, since at least some of the class transactions will have involved the surrender of a covered security.

Statutory Accounting Fraud Under RICO

BY STEPHEN JORDEN

Echoing New York's regulatory criticism concerning the use of captive reinsurers and similar allegations in recent class actions filed against several New York life insurers, an annuity contract owner has filed a putative nationwide class complaint against Fidelity & Guarantee Life Insurance Company (F&G), its indirect parent, Harbinger Group, Inc., and two affiliates based on allegations of statutory accounting fraud. Unlike the other cases, which asserted violations of New York insurance law, plaintiffs are pursuing their claims under the Racketeer Influenced and Corrupt Organization Act (RICO), 18 U.S.C. § 1961 *et seq.*

The crux of the complaint, in *Ludwick v. Harbinger Group, Inc.* (filed in federal court in Missouri), is that, shortly after being acquired by Harbinger, F&G used non-economic, "sham" reinsurance transactions to offload billions of dollars in liabilities to recently formed captive reinsurers and Wilton Re, an independent reinsurer not named as a defendant. These transactions and practices allegedly permitted F&G to misstate its surplus and risk-based capital ratio to, among others, regulators and ratings agencies. Plaintiff claims that, on the purchase date, she and fellow F&G annuity purchasers suffered an immediate loss in the form of the "diminished value" of their annuities due to the alleged "undisclosed adverse financial condition and default risk" as well as supposedly lower interest and index credits.

The complaint faces significant legal hurdles. For example, **many courts have found that similar diminution-in-value injury theories do not constitute "injury to business or property" under RICO because, *inter alia*, increased default risk is a speculative injury**. And the lawsuit appears to invade a core area of state insurance regulation—the financial condition of life insurers—which the defendants have argued warrants dismissal under the McCarran-Ferguson Act. If the complaint survives dismissal, plaintiff also will face obstacles demonstrating class-wide reliance as most courts have found that reliance is a necessary element of causation under 18 U.S.C. § 1964(c) in civil RICO claims alleging fraudulent inducement. One paragraph of the complaint claims that the "price" of the annuities was inflated by the alleged fraud, suggesting that plaintiffs will argue in the alternative a "fraud-on-the-market" causation theory similar to that employed in federal securities law cases.

Are Custodial Accounts Guaranteed a Guaranty?

BY WHITNEY FORE

The Insured Retirement Institute (IRI) is investigating whether state guaranty funds cover annuities housed in custodial accounts, including IRA custodial accounts. During the IRI's monthly call in March, the chief counsel of the Florida Life and Health Insurance Guaranty Association confirmed the Association's interpretation of the applicable Florida law: an annuity held in a custodial account is not covered by the guaranty association.

According to Florida Insurance Code § 631.713(3)(l), the guaranty association only covers annuities that are issued to and owned by a named "individual." That term is contrasted with a "person," which is defined to mean "any individual, corporation, partnership, association, or voluntary organization." Thus, the inclusion of the word "individual" in Section 631.714(9) means that the only annuities covered by the association are those issued to named individual people and not to corporations, partnerships, associations, or voluntary organizations.

This is significant because **many typical IRA custodial accounts are owned by "persons" and not "individuals," meaning they are excluded from coverage by the guaranty fund**. Florida's state issues group believes this excludes from coverage roughly half of all annuities sold in the state.

According to Amy Mignogna, IRI's Vice President of Strategic Initiatives, the organization next plans to determine if other states' guaranty association laws are similar to that of Florida. IRI, concerned that excluding custodial accounts from guaranty coverage would have a chilling effect on the sales of annuities to be held in those accounts, is also considering a lobbying campaign to change the law.

Federal Regulation of Fixed Equity Indexed Annuities Redux?

BY GARY COHEN

When SEC Commissioner Luis A. Aguilar recently cited "the need for the Commission and state regulators to focus on combatting fraud involving complex securities" including "equity-indexed annuities," he did not discuss specific details concerning indexed annuities. It is, therefore, unclear whether he advocates for enhanced state regulation or, less likely, a Commission effort to obtain Congressional authority for federal regulation.

The obstacles to federal reform include the so-called Harkin amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which effectively bars federal regulation of indexed annuities. One year prior, the U.S. Court of Appeals for the District of Columbia vacated SEC Rule 151A, intended to regulate indexed annuities, on procedural, not substantive, grounds.

SEC Commissioner Aguilar: Products like equity-indexed annuities "can be very opaque and complex for retail investors to fully appreciate the risks involved."

Commissioner Aguilar's statement was made in an address at a North American Securities Administrators Association conference in April. The SEC's liaison to the Association, Commissioner Aguilar focused on "complex securities," which he defined to include "securities that often involve embedded derivatives and may include equity-indexed annuities, leveraged and inverse exchange-traded funds (ETFs), principal protected notes, and reverse convertibles," as well as "exchange-traded products … and alternative mutual funds."

The Commissioner observed that "given the low interest environment that's been prevalent these past years, many investors" are "more likely to chase yield by buying investments touting higher returns." He warned that "these investment products can be very opaque and complex for retail investors to fully appreciate the risks involved" and that these investors "become easy prey for fraudulent schemes that are cloaked as investments in complex securities."

$84 Million Settlement in Northwestern Mutual Annuity Class Case

BY JASON MORRIS

March 26 marked the beginning of the end for the storied 14-year litigation concerning Northwestern Mutual Life Insurance Pre-MN annuities when the Eastern District of Wisconsin granted preliminary approval of a proposed class action settlement in *LaPlant v. Northwestern Mutual Life Insurance Company.*

Plaintiffs in *LaPlant* alleged that, starting in 1985, Northwestern Mutual changed its dividend calculation methodology so that the amount of dividends credited to the class annuity accounts would be based on interest earned on "short-term bonds exclusively and secretly chosen by" the company, rather than on the purported contractually-required "share of Northwestern's annual profits or 'divisible surplus'" basis. If the settlement is ultimately approved by the federal judiciary, those who terminated or annuitized their policies prior to 1994, which is estimated to be over half of the 33,000 annuitant class members, will each be eligible for $250. The remaining $84 million fund, minus fees and costs, will be available for the rest of the class members, based on each annuity's average net cash value and number of years the annuity was held.

LaPlant is not the first attempt by class counsel to recover funds from the company regarding this alleged change. In *Noonan v. Northwestern Mutual Life Insurance Company*, a 2001 Wisconsin state court case, class certification status was denied, a result affirmed by the Court of Appeals of Wisconsin in 2006. Nevertheless, *Noonan* remains pending as a stayed individual action. Cases brought by class counsel against Northwestern Mutual in Florida, California, and Washington also remain pending and will be dismissed if the settlement is ultimately approved.

A hearing on the proposed settlement is scheduled for August 21, 2015.

Sixth Circuit Holds No Disgorgement of Profits Based on Wrongfully Denied ERISA Disability Benefits

BY BEN SEESSEL

The Sixth Circuit Court of Appeals, sitting *en banc*, recently decided a closely-watched case regarding the scope of "other appropriate equitable relief" under ERISA Section 502(a)(3). In *Rochow v. LINA*, the court held that plaintiff Rochow, a high-level insurance executive, was made whole through his recovery, under ERISA Section 502(a)(1)(B), of wrongfully denied long-term disability benefits, attorney's fees, and the possibility of obtaining pre-judgment interest. Consequently, it vacated the district court's multimillion dollar "disgorgement of profits" award under Section 502(a)(3) as a "duplicative recovery" not permitted under ERISA.

Because this and related issues on the question of available remedies under ERISA are among the most hotly litigated ERISA issues currently in the courts, *Rochow* is likely to be a frequently cited case in the area.

The *en banc* court rejected plaintiff's argument that the denial of benefits and a continued withholding of those benefits, yielding defendant profits, constituted separate injuries, and held that plaintiff was improperly "repackaging" his claim for benefits under Section 502(a)(1)(B) by seeking further relief under Section 502(a)(3). Further, citing *Varity Corp. v. Howe*, the court held that plaintiff could only obtain "other appropriate equitable relief" under Section 502(a)(3) where there was no other adequate remedy under ERISA, and that Section 502(a)(1)(B) provided remedies adequate to redress plaintiff's injuries.

Had the *en banc* court sided with the plaintiff, the impact on employee benefit plans and their sponsors, as well as administrators operating in the ERISA-governed space, could have been profound. Because this and related issues on the question of available remedies under ERISA are among the most hotly litigated ERISA issues currently in the courts, *Rochow* is likely to be a frequently cited case in the area. Carlton Fields Jorden Burt submitted an *amicus* brief on behalf of several trade associations in support of LINA in the *en banc* proceeding.

Regulators Compose New Music for Broker-Dealers and Investment Advisers

BY KYLE WHITEHEAD

Federal regulators finally seem to be sharpening their pencils to achieve greater harmony between broker-dealer (BD) regulation and investment adviser (IA) regulation.

In March, for example, SEC Chair Mary Jo White testified to Congress that the agency's staff is developing rule recommendations to "harmonize" the standards of conduct applicable to BDs and IAs when providing personalized retail investment advice. Specifically, she believes such standards should be "codified, principles-based, and rooted in the fiduciary duty applicable to [IAs]."

In a parallel initiative, the Department of Labor (DOL) in April issued a reworked version of its 2010 proposal to redefine "fiduciary" under ERISA and the Internal Revenue Code and in other ways to address conflicts of interest in the provision of retirement investment advice. For more about the DOL proposal, *see* "Department of Labor Proposal Would Fundamentally Alter Fiduciary Relationship" on page 14.

Chair White and the DOL say the two agencies have been coordinating closely to minimize the possibility of conflicting or duplicative requirements. Consistent with the apparent thrust of the SEC's initiative, the DOL's proposal would impose on many BDs who provide advice in the retirement plan context duties that are more akin to those that already apply to IAs.

In some respects, however, "harmonization" also is likely to subject IAs to requirements that are more like those now applicable to BDs. For example, IAs currently are subject to much less frequent regulatory examinations than are BDs, and there is wide agreement that this disparity should be reduced—partly to promote uniform compliance with fiduciary duty requirements.

Because SEC budgetary constraints have prevented the SEC from examining IAs frequently enough, Chair White's March testimony also advised Congress that the SEC staff's work on fiduciary duty harmonization would address this issue. Specifically, the staff will make recommendations for the SEC to consider a program of IA compliance reviews by non-governmental "third parties" to supplement the IA examinations that the SEC staff itself conducts.

SEC Staff Ready to Recommend Variable Annuity Summary Prospectus

BY GARY O. COHEN

William Kotapish, an Assistant Director in the SEC's Division of Investment Management, recently stated that the SEC staff is prepared to recommend that the Commission adopt rules and forms authorizing a variable annuity summary prospectus similar to that for mutual funds. (For background, see the author's article "SEC Again Delays Variable Annuity Summary Prospectus" in the Summer 2014 edition of *Expect Focus*.)

Kotapish spoke at the March PLI Investment Management Institute in New York City. He confirmed that the Commission is scheduled to consider the matter in October, but couldn't guarantee the date because of the Commission's rulemaking workload under the JOBS and Dodd-Frank Acts. He said that the recommendation was non-controversial and was not adversely impacted by recent staff problems with mutual fund summary prospectuses.

Can "Bad Actors" Wave Goodbye to SEC Waivers?

BY JOSEPH SWANSON

The SEC has been thinking harder before waiving automatic disqualifications that the federal securities laws and regulations impose on so-called "bad actors."

Without such waivers, companies may be barred from, among other things, being investment advisers or broker-dealers or privately selling securities in reliance on SEC Regulation D. For example, such automatic bars

can be triggered if a company, or certain of its related persons, has been the subject of court or administrative action based on a violation or alleged violation under the securities or commodities laws.

Some have asserted that the SEC has placed investors at risk by granting waivers too frequently and undermining the deterrent effect of automatic bars. Critics have included SEC Commissioners Kara M. Stein and Luis A. Aguilar. Dissenting from a waiver for a large financial institution, Commissioner Stein, for example, complained that the decision "may have enshrined a new policy – that some firms are just too big to bar." Congresswoman Maxine Waters echoed that sentiment and proposed legislation requiring that, before issuing a waiver, the SEC publish advance notice giving interested persons the opportunity to comment or request that the SEC hold a hearing.

SEC Chair Mary Jo White defended her agency's approach, asserting that waivers are granted only after careful analysis shows that a bar is unnecessary to protect investors. According to White, "[W]aivers were never intended to be, and we should not use them as, an additional enforcement tool designed to address misconduct or as an unjustified mechanism for deterring misconduct."

Although the proposed legislation faces doubtful prospects, the SEC's Commissioners, in light of the recent controversy, have been giving more attention to waiver requests, rather than allowing staff members to make the decisions. This has included imposing additional conditions on some waivers, all of which will likely complicate settlement discussions in many enforcement actions.

Still Threatened: Arbitration Clauses in Securities Customer Agreements

BY TOM LAUERMAN

In a report to Congress released in March, the Consumer Financial Protection Bureau (CFPB) takes aim at consumer agreements that require disputes to be resolved by arbitration.

The CFPB generally does not have jurisdiction over securities customers' agreements with broker-dealers or investment advisers, and the report concerns only agreements for checking accounts, credit or prepaid cards, payday or private student loans, and mobile wireless services. Nevertheless, the report, which was mandated by the Dodd-Frank Act, maintains pressure for the SEC or Congress to prohibit investment advisers and broker-dealers from requiring their customers to arbitrate disputes. *See* "Blue Sky Regulators Attack Pre-Dispute Arbitration Agreements" in the Summer 2013 edition of *Expect Focus.*

Is the CFPB Report a bad sign?

While not actually taking a position *pro* or *con* requiring consumers to arbitrate, some of the report's key findings are ominous:

- Consumers, as a group, obtain little in the way of recoveries from arbitrations.
- The overwhelming preponderance of consumer recoveries come from class action settlements.
- Most arbitration provisions prohibit consumers from participating in class actions, and this can act as a significant barrier to class actions.
- Most consumers are unaware of the existence or implications of any arbitration provisions.
- Consumers have not been shown to obtain lower prices as a result of being required to arbitrate their disputes.

As to the arbitration forum that it operates for broker-dealers and investment advisers, FINRA has been implementing a series of reforms that may help stave off some critics' persistent calls for FINRA to prohibit broker-dealers from requiring their customers to arbitrate any disputes. For example, in March, FINRA obtained SEC approval of a proposal to make its so-called "public" arbitrators more free of any securities industry connections. For background, *see* "FINRA Continues Investor-Friendly Arbitration Reforms" in the Spring 2014 edition of *Expect Focus*.

SEC Extends Rule 482 Relief to Non-ERISA Retirement Plans

BY MATTHEW W. BURROWS

The SEC staff issued a no-action letter on February 18 that is important for many participant-directed individual account retirement plans (including some established under Section 403(b) of the Internal Revenue Code) that are not subject to the Employee Retirement Income Security Act (ERISA).

In 2010, the Department of Labor adopted a rule requiring that specified performance and other investment-related information be provided to participants under participant-directed individual account plans that are subject to ERISA. While Rule 482 under the Securities Act permits information about investment companies to be provided to investors without being accompanied or preceded by those companies' full prospectuses, DOL-required disclosures did not comply with all the conditions for reliance on Rule 482. Nevertheless, the SEC staff issued a no-action letter in late 2011 under which it agreed, for ERISA plans, to treat the DOL-required disclosures as if they satisfied the conditions of Rule 482. **The SEC staff's February 18 letter extends that position to cover provision of the same disclosures required by the DOL rule to participants and beneficiaries in plans that are not subject to ERISA, thus permitting reliance on Rule 482 for such disclosures.**

The February 18 letter applies to certain non-ERISA Section 403(b) plans, including those that cover governmental or church employees or that are funded entirely through employee contributions. It also applies to governmental plans established under Section 457(b) of the Code, governmental plans established under Section 401(a), governmental excess benefits arrangements established under Section 415(m), church plans established under Section 401(a), non-governmental plans established under Section 457(b), and non-qualified deferred compensation plans of governmental or tax-exempt entities under Section 409A or 457(f).

Where non-ERISA plans offer participants a choice among investment options funding the plan, the staff's February 18 letter will make it easier to provide participants with useful information for comparing the costs and performance of those alternatives.

Broker-Dealers File Suspiciously Few Suspicious Activity Reports

BY EDWARD PAGE

Speaking at an anti-money laundering (AML) conference in February, SEC Director of Enforcement John Ceresney warned attendees that broker-dealers were under-filing suspicious activity reports (SARs). He said that broker-dealers in the United States have been averaging only about five SARs each year per firm, despite a high volume of transactions that warrant more such filings, with many broker-dealers filing none.

Promising that the SEC would pursue "stand-alone" violations (i.e., where the only alleged violation is failure to file a required SAR), Ceresney cited a recent SEC enforcement action against broker-dealer Oppenheimer, which aided a customer who engaged in large deposits and sales of penny stocks. While Oppenheimer AML compliance personnel detected a suspicious transfer, the firm filed no SAR.

In another example, amidst potential wash-trading and other forms of suspicious manipulation, a Wedbush Securities executive failed to file an SAR.

Noteworthy takeaways:

- Broker-dealers will be under increased SEC scrutiny for under-filing SARs for the foreseeable future.
- Emphasis will be made on how well broker-dealers are discharging their obligation to file meaningful and substantive SARs, rather than just "check the box" SARs that inadequately describe the suspicious activity.
- As a former federal prosecutor from the Southern District of New York, Ceresney and the SEC's point people who bring these enforcement actions will likely select readily provable cases where the evidence is strong and the defenses weak.

- The SEC will be pursuing "stand-alone" Bank Secrecy Act enforcement actions—such as those mentioned above—to send a message that the SEC considers SAR violations in and of themselves to be serious and that the under-filing must stop.

- An SEC broker-dealer task force will be looking at other options to increase compliance with a broker-dealers' obligation to file SARs.

After *Omnicare*: Opinion Statement Liability in SEC Registrations

BY JOHN CLABBY

The U.S. Supreme Court in March provided important guidance on the support required for expressions of opinion or belief in registration statements. In *Omnicare, Inc. v. Laborers District Council Construction Industry Pension Fund*, the Court interpreted Section 11 of the Securities Act of 1933, which allows suits against the issuer of securities if the registration statement "contain[s] an untrue statement of material fact" or "omit[s] to state a material fact … necessary to make the statements therein not misleading," and held that an expression of opinion or belief does not in itself violate Section 11 unless the issuer subjectively believed the statement to be untrue or the statement included "embedded" statements of untrue facts.

But, writing for the Court, Justice Kagan explained that "we believe" and "we think" are not "magic words." Liability arises if the statement "omits material facts about the issuer's inquiry into or knowledge concerning a statement of opinion, and if those facts conflict with what a reasonable investor would take from the statement itself."

For example, according to Justice Kagan, a CEO's sincerely held claims about a product's "superiority," when she "failed to review any of her competitors' product specifications," would not be insulated from liability. Another example, in Kagan's view, could be an issuer's sincere belief in its compliance with applicable law, if stated "in the face of its lawyers' contrary advice" that was not disclosed.

In light of *Omnicare*, it will be important to consider whether the level of certainty that a reasonable investor would, under all the circumstances, ascribe to a statement of opinion or belief is fairly aligned with the information then in the issuer's possession. If not, it may be necessary to seek additional support for the statement or to omit, qualify, or otherwise revise it.

Much future litigation doubtless will turn on these questions, as the Court's opinion provides little guidance on how its general principles should be applied in specific cases.

DOL Proposal Would Fundamentally Alter Fiduciary Relationship

BY STEPHEN W. KRAUS & ZACHARY D. LUDENS

Nearly five years after proposing a failed rule that would have dramatically expanded the definition of fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA), the Department of Labor has decided to try again. On April 14, the Department released a series of proposed rules, regulations, and exemptions under ERISA. The proposal dramatically expands the definition of a "fiduciary" as to plans subject to ERISA, sweeping in many insurance agents, broker/dealers, advisers and others that were not fiduciaries under the original regulation. The proposal also applies the same definition to the term "fiduciary" under the excise tax provisions of the Internal Revenue Code, sweeping in individuals or entities that offer investment advice to IRAs and health savings accounts. If enacted in its present form, the proposal will also likely dramatically alter current compensation arrangements. Although these proposals are open to comment until July 6, 2015, all those dealing with employee benefit plans covered by ERISA, as well as IRAs, should pay close attention to the proposal now.

The fundamental shift relates to the definition of "investment advice." Under the new definition, a person becomes a "fiduciary" by providing:

1. recommendations as to the acquisition, holding, disposing or exchanging of securities or other property,
2. management of securities or other property, including IRA rollovers,
3. an appraisal or fairness opinion, or
4. recommendations as to persons to provide the investment advice or to manage plan assets for a fee.

The person making one or more of the recommendations discussed above, must also represent or acknowledge, either directly or indirectly, their fiduciary status or provide the advice under an agreement, arrangement, or understanding that the advice is individualized to, or specifically directed to, the recipient for consideration in making investment or management decisions as to securities or other property. **This latter requirement is a dramatic change from the current definition of "fiduciary"** which requires that the advice be furnished on a "*regular basis*" pursuant to a "*mutual*" agreement or understanding, and that it must serve as the "*primary basis"* for investment decisions.

The proposal provides a number of "carve-outs" from the general definition of fiduciary outlined above, subject to certain conditions depending on the nature of the "carve-out." For example, there is a "carve-out" for service providers, such as record keepers or third-party administrators, that offer a platform of investment vehicles to participant-directed individual account plans if a plan fiduciary chooses the specific investment alternatives that will be made available to the plan's participants. Importantly this "carve-out" does not apply to IRAs. The proposed regulation also provides a "carve-out" for investment education similar to that provided in Interpretive Bulletin 96-1, so long as the information and materials do not include advice or recommendations as to specific investment products.

The Department is also proposing a new prohibited transaction class exemption, the *Best Interest Contract Exemption*, which would allow fiduciaries to receive compensation that would otherwise not be permitted (*e.g.,* commissions, revenue sharing, 12b-1 fees and shareholding servicing fees). The proposed exemption contains several limitations and conditions that may make it impractical to rely on. Most significantly, before any advice is given, the person must enter into a written contract acknowledging his/her fiduciary status and must commit to provide advice in the "best interest" of a plan's participants and beneficiaries. The adviser must also provide certain warranties as well as disclose any material conflicts of interest. The "best interest" standard is almost identical to that part of ERISA's Section 404(a)(1)(B) prudent man standard of care. Moreover, the exemption only applies to advice provided

to plan participants and beneficiaries in participant-directed account plans, IRA owners, and plan sponsors of non-participant directed plans with fewer than 100 participants. It does not cover fiduciaries who have discretionary authority over the administration of the plan or IRA. It is critical that the proposed exemption would create *a private right of action* for breach of contract if an advice recipient, including an IRA owner, believed the adviser did not act in his/her best interest.

Finally, the Department is also proposing to modify several existing prohibited transaction class exemptions including PTE 84-24, which covers transactions involving insurance or annuity contracts sold to plans or IRA investors by pension consultants, insurance agents, or brokers. The exemption allows these fiduciaries to receive a sales commission, subject to certain conditions, regarding products purchased by plans or IRA investors. The proposed modifications include: (1) requiring all fiduciaries relying on the exemption to adhere to the same impartial conduct standards required in the Best Interest Contract Exemption; (2) revoking reliance on the exemption as to transactions involving variable annuity contracts and transactions involving the purchase of mutual fund shares with respect to IRA investors; and (3) narrowing the definition of commissions to exclude revenue sharing, administrative or 12b-1 fees. To receive such compensation, or any variable compensation related to the sale of a variable annuity contract, the insurance agent or broker will have to rely on the Best Interest Contract Exemption.

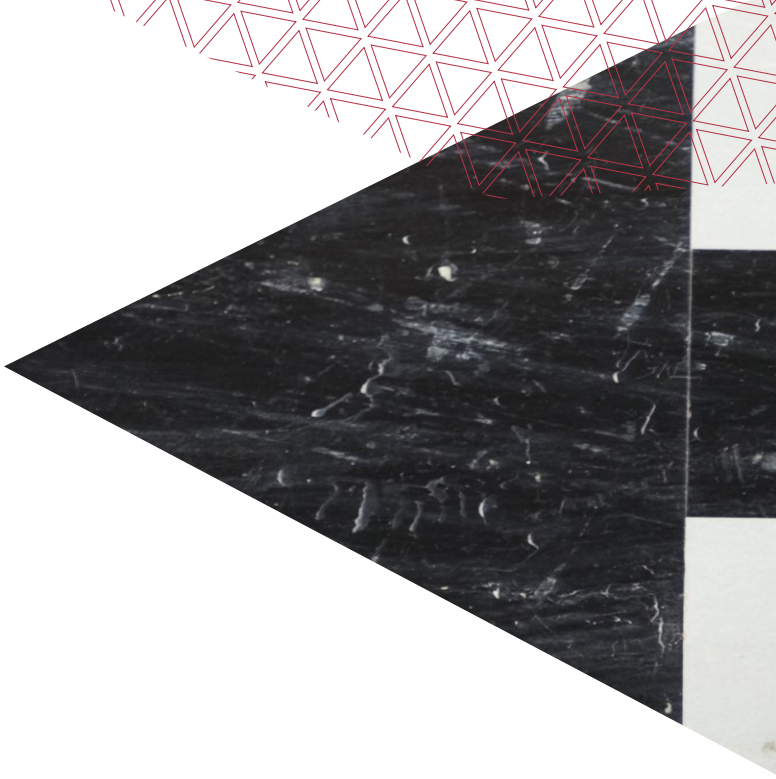
Based on the reaction to the 2010 proposal, there will be numerous comments on the current proposal and an extensive lobbying effort to obtain significant changes to the proposed rule. It is unlikely that a final rule will be adopted this year. Some predict that a final rule will not be adopted before the end of President Obama's term. We at Carlton Fields Jorden Burt continue to analyze the proposal and monitor developments. We are also prepared to help our clients determine the proposal's impact on their businesses.

SEC Puts *Janus* in its Place

BY MICHAEL VALERIO

Interpretive positions adopted in a recent SEC opinion will, if accepted by the courts, greatly undermine the significance of the U.S. Supreme Court's 2011 opinion in *Janus Capital Group, Inc. v. First DerivativeTraders*.

Janus held that an investment adviser to a mutual fund was not the "maker" of allegedly false statements in the fund's prospectus for purposes of liability in a private action for violations of SEC Rule 10b-5(b).



The Court reasoned that because the fund, which filed the prospectus, had "ultimate authority" over the prospectus's content and dissemination, the adviser could not have "made" the statements at issue even if the adviser was "significantly involved" in preparing the prospectus.

Nevertheless, **under the SEC's interpretations in *In the Matter of John P. Flannery and James D. Hopkins*, most, if not all, actions that could be brought under Rule 10b-5(b) *also* could be brought under Rule 10b-5(a) or (c)**. Moreover, the SEC expressed the view that *Janus* has no applicability to Rule 10b-5(a) or (c) because the terms of those subsections do not require that the alleged violator be the "maker" of any statement at issue. Under the SEC's analysis, therefore, avoiding the Supreme Court's holding in *Janus*–limiting Rule 10b-5(b) liability to "makers" as defined by the Court – could require nothing more than pleading a violation of one or both of those other subsections, rather than subsection (b).

In the course of its nearly 60-page opinion in *Flannery*, the SEC expressed its views on a wide variety of interpretive questions. Two SEC Commissioners, Republicans Gallagher and Piwowar, dissented from the opinion, however, and several of the SEC's positions will doubtless stir controversy. We urge interested readers to grab a cup of coffee and spend some time absorbing the many contours of this deliberately crafted SEC opinion.

Telematics and Usage-Based Insurance

BY JOHN PITBLADO

The NAIC's Center for Insurance Policy and Research (CIPR) released a white paper analyzing the future of "telematics" in premium rate-making by auto insurers.

Telematics allow for the measurement of actual driving habits, through remote access to a vehicle's real-time driving data. Thus, a driver's actual experience can be studied in data transmitted from, for example, the vehicle's navigation system, speedometer, odometer and tachometer, braking and acceleration systems, suspension system, engagement of anti-lock brakes, late-night driving habits, and more.

Auto insurers have discovered telematics, which have been used in some forms since cars became computerized in the 1980s, as a means to better understand the risks they insure. Information about actual driving experience allows insurers to much more accurately price their products, and predict risks.

NAIC discusses the many benefits of insurers' use of telematics—for insurers, their customers, and the public at large. The most touted benefit of usage-based insurance (UBI) is that it gives consumers greater control over their premium costs. It allows insurers to reward those who already drive safely, and motivate those who do not to improve in order to lower premiums. According to the NAIC, evidence from Canada and the UK indicates that increased UBI use improves driver behavior. Given the general societal benefit of increased road safety, it may be expected that policymakers will increasingly seize on UBI as a public safety issue. The employment of UBI may also reduce insurers' reliance on historical rating factors that sometimes resulted in unfair discrimination, leading to regulation. **Particularlizing rate-making to individuals, rather than demographic groups, could mitigate potential unfair discrimination in older rate-setting models.**

NAIC's paper also explores some of the challenges telematics pose for insurers. These include what data to record—and how to store it, what type of technology to employ, and how to analyze the data in useful ways to determine risk levels, and, consequently, premium levels.

Ultimately, insurers may be forced to jump on the bandwagon, as several major insurers are already providing UBI incentive programs, lowering premiums for drivers that establish with data their safe driving habits. According to NAIC, "[a]s the use of telematics grows, companies will have to include both increases and decreases to rates in order to avoid adverse selection." At least one insurer recently announced it will also raise premiums on drivers who choose the program, and are revealed to be riskier drivers.

As UBI becomes more widespread, questions will inevitably arise that will leave consumers, regulators, and insurers grappling with a host of unforeseen consequences.

Florida Federal Court Limits First Party Bad Faith Claims

BY JEFFREY MICHAEL COHEN & ZACHARY D. LUDENS

First party bad faith actions in Florida must be pursued under §624.155 Florida Statutes because Florida does not recognize common law first party claims. The statute provides that an insured may bring a civil action against an insurer for "not attempting in good faith to settle claims when, under all the circumstances, it could and should have done so had it acted fairly and honestly toward its insured."

As a condition precedent to filing suit, the insured must first file a Civil Remedy Notice (CRN) with Florida's Insurance Department and provide a copy to the insurer. The statute must be strictly construed and the CRN is crucial to the integrity of an action under the statute.

The CRN must "state with specificity" the statutory provision allegedly violated and the facts and circumstances giving rise to the violation. The purpose of the CRN requirement is to set forth the basis of the insured's bad faith allegations to allow the insurer an

opportunity to remedy the problem. The insurer has 60 days from receipt of the CRN to "cure" the alleged bad faith and avoid litigation. Essentially, the statute provides for specific notice of bad faith conduct and a 60-day safe harbor within which the insurer may resolve the dispute and preclude the insured from asserting a bad faith claim.

In *Fox Haven of Foxfire Condo IV Ass'n Inc. v. Nationwide Mut. Fire Ins. Co.*, the insured condominium association alleged that the insurer failed to properly investigate and settle a claim for damages caused by Hurricane Wilma. After the storm, the association and the insurer disagreed on the damage amount. The insurer paid the amount of its estimate and the association invoked the policy's appraisal provision to resolve the dispute concerning the amount owed. During the appraisal process, the association filed a CRN alleging that the insurer was not attempting to settle the claim in good faith. The insurer did not take advantage of the opportunity to cure. The appraisal panel rendered a damage award that was more than 10 times the insurer's payment, but the insurer failed to promptly pay the award. Ultimately the award was paid.

Following payment, the condo association filed a statutory bad faith action to recover damages allegedly caused by the insurer's bad faith, plus punitive damages. The association alleged that the insurer's delay in failing to promptly pay the appraisal award constituted bad faith.

The U.S. district court disagreed because "an insured cannot establish bad faith via insurer conduct that occurred after the CRN's 60-day cure period." The court held that the purpose of the CRN is to provide the insurer with the opportunity to correct the circumstances that gave rise to the bad faith action. **Thus, any action or inaction that occurred after the end of the cure period cannot support a bad faith claim because it is impossible for an insurer to remedy bad faith that has not yet occurred.** Accordingly, the court entered summary judgment for the insurer regarding all claims of bad faith conduct that occurred after the CRN was filed.

The court also entered summary judgment on the association's punitive damage claim because the proof offered by the association to establish the insurer's general business practices was based partly on evidence that hundreds of CRNs were filed alleging that the insurer made inadequate settlement offers. The court ruled that the many similar CRN filings were merely evidence that other insureds were dissatisfied with the insurer's initial assessment of their claims. The CRNs, however, were not evidence that the insurer evaluated the other claims in bad faith.

Stretched for Resources, the IRS Sets Its Sights on Small Captive Insurers

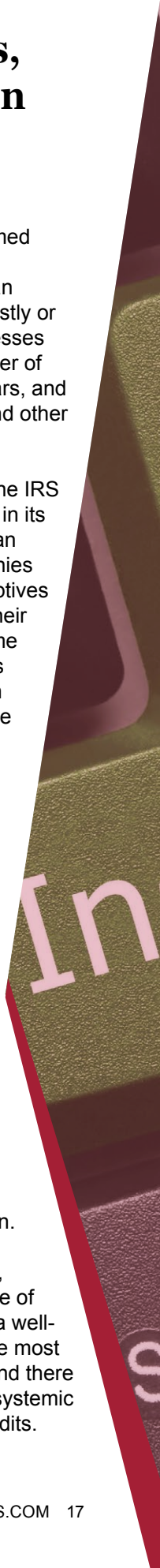
BY RICHARD EULISS

A "captive" insurance company is an insurer formed for the limited purpose of insuring the risks of its non-insurer owner or owners. A captive can be an effective risk-management tool, especially for costly or unconventional risks, and it can also give businesses direct access to reinsurance markets. The number of captives has increased fivefold in the last 30 years, and U.S. jurisdictions now compete with Bermuda and other offshore locations to be captive domiciles.

But not everyone is enthusiastic: most notably, the IRS listed abuse of captive insurers for tax purposes in its "Dirty Dozen" list of 2015 tax scams. Captives can provide tax advantages, because parent companies can deduct the premiums they pay, while the captives may exclude premiums up to $1.2 million from their income and elect to pay tax on investment income only. The agency says "unscrupulous" promoters encourage companies to shelter income by such means as paying exorbitant premiums to offshore captives for poorly-written insurance that merely duplicates coverage the parents maintain with conventional insurers.

Even before it released the 2015 list, the IRS issued what many view as confusing (if not downright inconsistent) guidance on captives. It also began a significant number of audits of persons it suspected of marketing captives for tax avoidance purposes. Such promoters often tout captives as an efficient means of estate planning and managing other property transfers. In a promoter audit, the IRS typically demands—and often obtains—a client list, which it uses to launch further inquiries, not only of the captives linked to the audited promoters, but also of affiliated entities and individuals.

Recently, these audits have reached the level of a purposeful and strategic examination campaign. Thus, the latest announcement makes clear the agency's intent to ramp up pressure on captives, and the industry can expect a significant increase of related tax controversies. Currently undergoing a well-publicized downsizing, the IRS must prioritize the most efficient means of collection and enforcement, and there is "more bang for the buck" in concentrating on systemic threats than in pursuing a strategy of random audits.



Providers Await Result on Affordable Care Act Challenge

BY JON GATTO

Challenging a holding by the Fourth Circuit Court of Appeals before the U.S. Supreme Court in *King v. Burwell*, counsel Michael Carvin argued that the Affordable Care Act does not allow the federal government to issue tax credits to individuals who purchase health insurance on federal exchanges. To the contrary, he argued, it makes tax credits available only for plans "enrolled in through an Exchange established by the State."

During the March 4 oral arguments, Justices Kagan, Ginsburg, and Breyer were concerned about interpreting the Act so narrowly. As Justice Kagan put it, "[W]e are interpreting a statute generally to make it make sense as a whole … We look at the whole text. We don't look at four words."

Justices Sotomayor and Kennedy further questioned whether the challengers' interpretation would render the Act unconstitutionally coercive. Justice Sotomayor observed that under the challengers' interpretation, the federal government tells the states: "[E]ither create your own Exchange, or we'll send your insurance market into a death spiral."

On behalf of the government, Solicitor General Donald Verrilli argued that the Act must be read in its full context. **The challengers' interpretation, he argued, would create "rump exchanges doomed to fail."** That, he urged, would defeat the Act's purpose, which is to reduce the number of uninsured Americans.

Justice Scalia questioned whether the government's interpretation was an effort to "twist the words" of the Act, and Justice Alito questioned why Congress would have used the words "established by the State" if it intended something else.

Supreme Court watchers are expecting a decision to be issued in late June or early July.

Telemedicine: Hitting a Few Speed Bumps

BY PATRICIA S. CALHOUN

Despite faster Internet connections, better software, increased availability of devices with built-in video, and an increasingly tech-savvy public, the broad acceptance of telemedicine—the use of telecommunication and information technologies in order to provide clinical health care at a distance, has not expanded as rapidly as expected.

In 2015, 36 states introduced over 100 bills relating to telemedicine. Unfortunately, only 10 states introduced legislation that would expand the physician licensing process to encompass telemedicine, while six introduced bills that would require parity for telemedicine under private insurance. Licensing and payment parity are two issues necessary for telemedicine's smooth expansion.

Additionally, some states have flatly refused to fully adopt the telemedicine model. Arkansas lawmakers recently rejected House Bill 1747 that would have allowed video consults as a first patient encounter. Opponents argued that all patients deserved face-to-face medical care. Arkansas joined Alabama, Missouri, and Nebraska in requiring an initial in-person visit.

The Texas Medical Board also stunted telemedicine's expansion by changing its rules to hold that "questions and answers exchanged through email, electronic text, or chat or telephonic evaluation of or consultation with a patient" are inadequate to establish a doctor-patient relationship. In other words, **Texans will also need to have an in-person examination before a physician can make a telemedicine diagnosis or order prescription medications.**

In addition, Idaho passed legislation to join 16 states that prohibit physicians from ordering abortion-inducing drugs via telemedicine.

And, although the Centers for Medicare & Medicaid Services (CMS) expanded its coverage of telemedicine to include additional services in 2015, it did not change the requirements that the patient must be located in a rural area and a qualified originating site to qualify for

reimbursement. Proponents argued that reimbursement for telemedicine should be available to all patients regardless of their geographical location, but CMS stated that it did "not have the authority to implement" such revisions under the current statute.

Despite these setbacks, telemedicine's use and acceptance is expected to rapidly expand. Under the Affordable Care Act, providers and patients must search for cost cutting opportunities to provide necessary care. In addition, the American Medical Association endorses the delivery of telemedicine services and telemedicine support is already offered by most large health care insurance companies, signaling that telemedicine is becoming more common and accepted every day.

A New Era of HIPAA Enforcement

BY MARISSEL DESCALZO

Traditionally, HIPAA enforcement is assigned to the Department of Health and Human Services' Office for Civil Rights (OCR). In November 2013, Health and Human Services' Office of Inspector General sharply criticized OCR's HIPAA enforcement efforts. OCR responded with swift action regarding providers' data protection responsibility.

OCR's aggressive enforcement of HIPAA security requirements is expected to continue into 2015.

The first sign of a new HIPAA enforcement era came in late December 2013, when OCR levied the first fine against an entity for failing to implement policies to address a data breach. The fine was issued even though there was no evidence that any individuals were harmed (or even that any patient files were accessed).

Further evidence of this new era in provider enforcement came in April 2014 when Concentra Health Services agreed to a $1.7 million fine and a corrective action plan following the theft of a unencrypted laptop from a Missouri physical therapy center. Also in April 2014, QCA Health Plan, Inc. agreed to pay a $250,000 fine and a corrective action plan after an unencrypted laptop was stolen from an employee's car.

Parkview Health Systems settled a rare low-tech HIPAA breach case in June 2014, agreeing to pay $800,000 in fines and to institute a corrective action plan. In June 2009, Parkview employees delivered 71 boxes of patient files to the home of a retiring physician. Knowing that the physician was not at home, the employees left the boxes in the physician's driveway. OCR noted that the boxes were left "unattended and accessible … within 20 feet of a public road and a short distance away from a heavily trafficked public shopping venue."

May 2014 brought the largest HIPAA settlement to date. New York-Presbyterian Hospital and Columbia University collectively agreed to pay $4.8 million. The underlying breach occurred when the deactivation of a server by an individual physician, along with a lack of technical safeguards, allowed patients' electronic protected health information to be accessible through public Internet search engines. During OCR's investigation, the agency learned that neither the hospital nor Columbia University had undertaken any risk analysis or verified the server's security. OCR described the case against the joint entities as a means to "remind health care organizations of the need to make data security central to how they manage their information systems." The entities also agreed to a corrective action plan.

In addition to taking stronger HIPAA enforcement actions, OCR has begun to refer HIPAA breaches for criminal prosecutions. Historically, criminal enforcement of HIPAA violations was rare. In one such prosecution, *United States v. Joshua Hippler*, Hippler allegedly obtained private health information with the intent to sell, transfer, or use it for personal gain. In Hippler's case, the government did not allege inadvertent disclosure or failure to secure data, but rather an intentional effort to profit from private and personal data. Hippler pleaded guilty in August 2014 and was sentenced to 18 months.

OCR's aggressive enforcement of HIPAA security requirements is expected to continue into 2015. In June 2014, an OCR Chief Regional Counsel, Jerome Meites, warned at an American Bar Association conference that the previous 12 months' enforcement efforts, through which OCR collected more than $10 million in HIPAA fines, would "be low in comparison to what's coming." He said OCR intended to focus on "high impact cases" to send strong messages about the importance of data security. Meites observed that the failure to conduct a thorough risk analysis was a common thread in the cases OCR identified. Additionally, he noted that portable media have become a particular vulnerability for health care providers.

In an August regulatory filing, Community Health Systems announced that it had been hacked by a group believed to be based in China. The hackers stole identification data for 4.5 million patients. It will be interesting to see how OCR approaches the case in 2015, and what Community Health Systems discloses in its public filings concerning the possible prosecution of this matter.

RadioShack's Consumer Data: A Highly Scrutinized Asset

BY GAVRILA A. BROTZ

Following the Texas Attorney General's objection to the sale of RadioShack Corporation's consumer data as an asset in its bankruptcy, 37 other state attorneys general and a large number of other consumer protection entities formally raised similar concerns. RadioShack, which filed for bankruptcy on February 5, 2015, revealed in a representative's deposition on March 20, 2015 that it held personally identifiable consumer data of 117 million consumers, or 37% of the residential population of the United States. The State of Texas filed an objection in the bankruptcy proceeding, arguing that the sale of this personally identifiable consumer data would breach RadioShack's privacy policies, thereby violating states' consumer protection laws. Texas's objection was formally joined and supported by dozens of other states who continued to monitor the potential sale of that asset closely.

RadioShack's consumer data is believed to be one of its estate's most valuable assets.

The U.S. Trustee and the Federal Trade Commission joined that chorus. The U.S. Trustee asked the court to exclude customer data from the sale of RadioShack's assets, and the FTC's Bureau of Consumer Protection's Director raised concerns that the sale or rental of protected data could constitute a deception or unfair practice under Section 5 of the FTC Act.

RadioShack had pulled the sale of its personally identifiable consumer data prior to the start of the auction of its assets on March 23, 2015, but later indicated that it would still seek to include that data as part of the sale of RadioShack's intellectual property assets. The dispute became more heated in advance of the auction of its intellectual property.

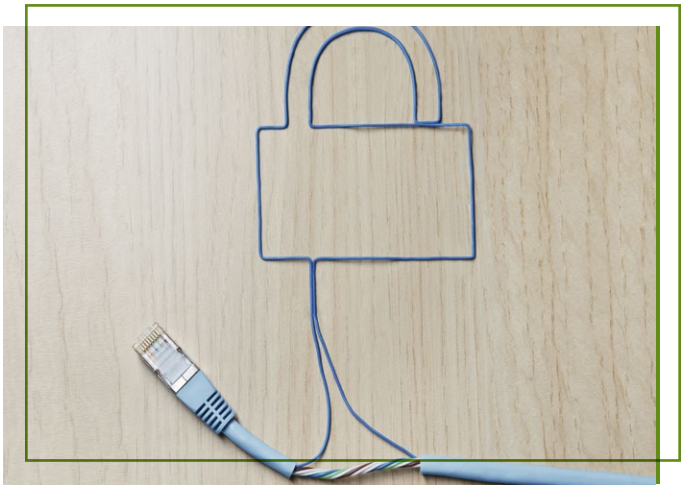
In the face of such opposition and concern, RadioShack mediated and ultimately settled with the states; the settlement was approved by the court on May 20, 2015. RadioShack agreed to destroy the vast majority of its consumer data, including its customers' credit and debit card numbers, Social Security number, dates of birth, and phone numbers. In fact, the new owner, General Wireless, will only retain the electronic mail addresses of individuals who specifically requested information from RadioShack during the past two years, and will not sell or share that information to any entity, including its partner, Sprint Communications. Representatives of the FTC's Bureau of Consumer Protection were also involved in the mediation and agreed with the ultimate deal.

The arguments over the sale of RadioShack's consumer data demonstrate the intense level of interest in consumer data protection. RadioShack's consumer data was believed to have been one of the most valuable of its estate's assets. This type of settlement could become the standard in future bankruptcies, as the value of consumer data continues to skyrocket along with the political interest in protecting it.

NYDFS Report Foreshadows New Cyber Security Regulations

BY ROBERT T. SCHMIDLIN

The New York State Department of Financial Services (NYDFS) has released a report entitled "Update on Cyber Security in the Banking Sector: Third Party Service Providers." The report details the findings of an October, 2014 survey of 40 banking organizations regulated by the department, and identified potential cyber security vulnerabilities with banks' third-party vendors. Banks rely on third-party vendors for a broad range of services and often have access to a financial institution's information technology systems, providing a potential point of entry for hackers to obtain sensitive customer data. Among the report's findings, the department found that 1 in 3 surveyed banks did not require third-party vendors to notify them of cyber security breaches.



As a result of the report's findings, **NYDFS is now considering new regulations for financial institutions, establishing cyber security standards applicable to their relationships with third-party service providers**, including potential measures related to the representations and warranties banks receive about the cyber security protections those providers have in place. These regulations could have a significant compliance impact on third-party service providers, including the title insurance industry.

The NYDFS report is the latest step it has taken examining cyber security issues among its regulated entities, and follows the publication of its initial May 2014 report on cyber security in the banking sector, its February 2015 report surveying insurers' cyber security readiness and plans, and issuance of a Section 308 letter in March requesting information technology reports from insurers in anticipation of conducting risk assessments.

State and federal actions, such as the NYSDFS's cyber security reports, expected regulations, and the Consumer Financial Services Bureau's clear statements that supervised banks are expected to oversee and monitor activities of their third-party service providers to ensure compliance with federal consumer finance laws, highlight the continued trend of an increasingly regulated environment, and corresponding liability risks, for these entities.

Eleventh Circuit: Enforcement of a Security Interest Is Not Debt Collection

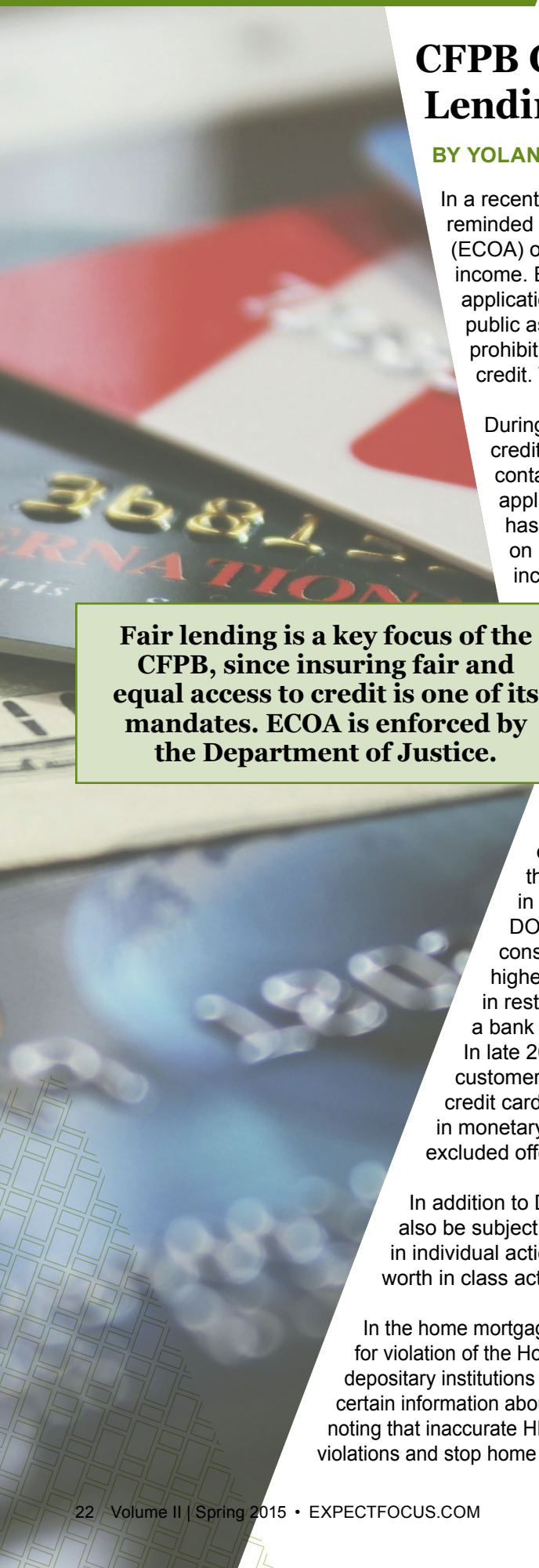
BY APRIL Y. WALKER & CHRISTOPHER SMART

The Eleventh Circuit Court of Appeals recently reaffirmed that enforcement of a security interest alone is not debt collection regulated by the Fair Debt Collection Practices Act (FDCPA).

In *Dunavant v. Sirote & Permutt, P.C.,* decided on February 9, 2015, the Eleventh Circuit found no error in a trial court's refusal to reconsider its ruling that the publishing of foreclosure sale notices by the defendant law firm did not amount to debt collection under the FDCPA. The trial court relied, in part, on *Warren v. Countrywide Home Loans, Inc.* for the proposition that "an enforcer of a security interest such as a [mortgage company] falls outside the ambit of the FDCPA except for the provisions of section 1692(f)(6)."

On appeal, the consumers argued that the 2009 decision in *Warren* was overruled by the 2012 decision in *Birster v. American Home Mortgage Servicing, Inc.* which held a defendant that "both attempt[s] to enforce a security interest *and* collect a debt" may be liable under the FDCPA beyond § 1692f(6). The Eleventh Circuit rejected that argument, finding no conflict between the opinions because the *Dunavant* trial court ruled that the publication of the foreclosure sale notices was part of the enforcement of a security interest and not part of the collection on a debt. In affirming, the Eleventh Circuit focused on the facts that the notices at issue **"were published in a newspaper to inform the public about the status of the foreclosure sale, were not addressed to the debtors, and included no information relating to the collection of payments from them."**

Thus, *Dunavant* confirms the distinction between an *in rem* foreclosure and attempts to collect a debt in the Eleventh Circuit.



CFPB Continues Crackdown on Fair Lending: Marketing Materials Targeted

BY YOLANDA P. STRADER

In a recent guidance bulletin, the Consumer Financial Protection Bureau reminded mortgage lenders to heed their Equal Credit Opportunity Act (ECOA) obligations when considering applicants receiving public assistance income. ECOA prohibits lenders from discriminating against any credit application because all or part of the applicant's income comes from any public assistance income, such as Social Security disability income, and its prohibitions encompass activities before, during, and after the extension of credit. Thus, marketing materials are covered by ECOA.

During recent CFPB examinations, multiple ECOA violations were found in credit provider marketing materials. For example, materials impermissibly contained statements regarding public assistance income or discouraged applicants who receive such income from applying for credit. The CFPB has warned that "[a] blanket practice of denying any applicant who relies on public assistance income, or a specific form of public assistance income, without an assessment of an applicant's particular situation violates the [ECOA and its implementing Regulation B]." The CFPB directed the offending lenders to "identify applicants who were wrongly denied on the basis of their protected income source, as well as potential applicants who were discouraged by marketing materials," to give those deterred by the marketing materials the opportunity to reapply, and to provide remuneration for consumers who were wrongly denied credit and subsequently lost their homes.

Fair lending is a key focus of the CFPB, since insuring fair and equal access to credit is one of its mandates. ECOA is enforced by the Department of Justice.

Fair lending is a key focus of the CFPB, since ensuring fair and equal access to credit is one of its mandates. ECOA is enforced by the Department of Justice (DOJ) but the CFPB is actively involved in supervising and examining for violations, and working with the DOJ to penalize violators and assess heavy monetary penalties. Two consent orders entered in 2013 against lenders found to have charged higher rates to minority applicants collectively awarded over $125 million in restitution and penalties, $98 million in damages and penalties against a bank financing auto loans, and $35 million against a mortgage lender. In late 2014, a credit card bank, found to have violated ECOA by excluding customers with "Spanish-preferred" indicators on their accounts from certain credit card product offers, was ordered to pay consumers a steep $169 million in monetary compensation found by the CFPB to represent the value of the excluded offer, plus interest, and indirect damages.

In addition to DOJ-CFPB enforcement actions, lenders who violate ECOA may also be subject to civil liability for actual and statutory damages (up to $10,000 in individual actions and the lesser of $500,000 or 1 percent of the lender's net worth in class actions).

In the home mortgage market, the CFPB has also entered enforcement orders for violation of the Home Mortgage Disclosure Act (HMDA), which requires depositary institutions and other mortgage lenders to publicly disclose certain information about mortgage applications and rejected applications, noting that inaccurate HMDA data impedes its efforts to detect ECOA violations and stop home mortgage lending discrimination.

Repeated Fax Blasts Cost Company $22 Million Judgment

BY APRIL Y. WALKER & ELIZABETH M. BOHN

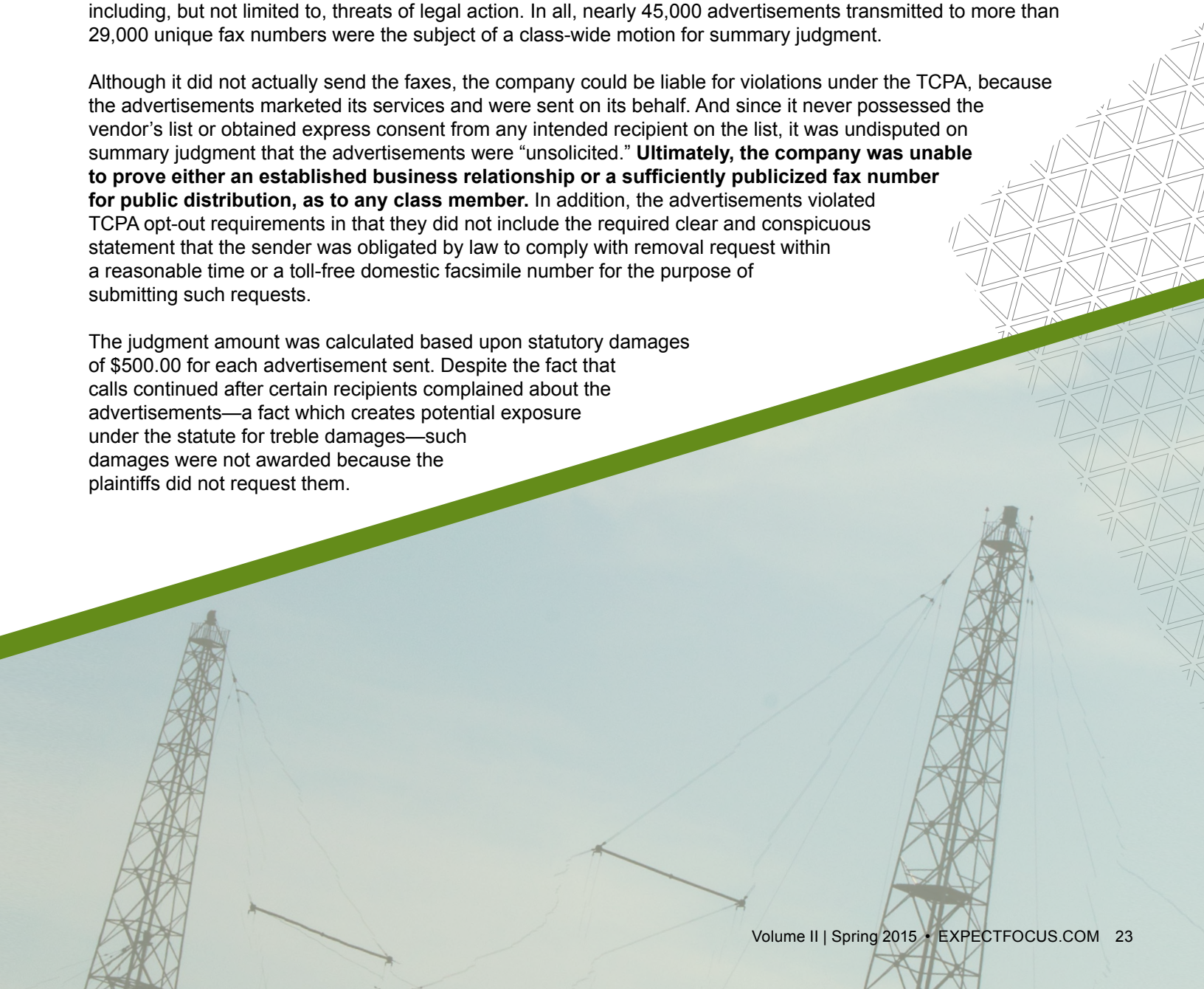
The Telephone Consumer Protection Act of 1991 (TCPA), 42 U.S.C. § 227(b)(1)(C), prohibits the fax transmission of unsolicited advertisements without the prior express permission of the recipient, absent an established business relationship between the sender and the recipient, voluntary provision by the recipient of the facsimile number to the sender within the context of such relationship (unless the sender obtains the facsimile number from a public source), as well as inclusion of clear, conspicuous opt-out language prescribed by the law on the first page.

In *City Select Auto Sales, Inc. v. David/Randall Associates, Inc. et al*, a New Jersey district court judge recently entered final summary judgment against a Pennsylvania commercial roofing company in the staggering amount of $22,405,000 for violating this prohibition.

The company utilized a third-party vendor to fax advertisements to U.S. companies on a list purchased by the vendor. Advertisements were transmitted in four separate "blasts." After the first blast, the company received complaints that the advertisements were unsolicited, that the number for opting out of future blasts did not work, and that the advertisements violated the law. Recipients that complained were removed from future blasts; however, additional blasts were ordered and transmitted. The company received complaints after each blast including, but not limited to, threats of legal action. In all, nearly 45,000 advertisements transmitted to more than 29,000 unique fax numbers were the subject of a class-wide motion for summary judgment.

Although it did not actually send the faxes, the company could be liable for violations under the TCPA, because the advertisements marketed its services and were sent on its behalf. And since it never possessed the vendor's list or obtained express consent from any intended recipient on the list, it was undisputed on summary judgment that the advertisements were "unsolicited." **Ultimately, the company was unable to prove either an established business relationship or a sufficiently publicized fax number for public distribution, as to any class member.** In addition, the advertisements violated TCPA opt-out requirements in that they did not include the required clear and conspicuous statement that the sender was obligated by law to comply with removal request within a reasonable time or a toll-free domestic facsimile number for the purpose of submitting such requests.

The judgment amount was calculated based upon statutory damages of $500.00 for each advertisement sent. Despite the fact that calls continued after certain recipients complained about the advertisements—a fact which creates potential exposure under the statute for treble damages—such damages were not awarded because the plaintiffs did not request them.



Cleared for Takeoff: Do You Need FCC Permission to Operate that Drone?

BY MATTHEW E. KOHEN

In recent years, the drone industry has proliferated, enjoying exponential growth in popularity and technological sophistication. Drone technology available to the general public has become increasingly advanced. Now, drones can fly great distances, and, in some cases, transmit a live video back to the operator to allow the drone to maneuver beyond the operator's visual line-of-sight. This has led to the popularization of first person view (FPV) flying. FPV flying allows drone "pilots" to experience their surroundings as if they are sitting in the drone's "cockpit." FPV flying has myriad applications in the commercial arena, and has been a subject of increasing popularity among businesses in the insurance, agricultural, entertainment, and logistics industries.

U.S. regulators have noticed. For example, on February 15, 2015, the Federal Aviation Administration (FAA) released a proposed framework regulating small-scale commercial drone use. However, with so much attention paid to the FAA's proposed regulations, it seems that few have considered the potential impact of regulations already in effect.

Depending on the power, type, and frequency of the radio transmission, a specialized license may be required.

One regulatory framework that may impact the multi-billion dollar drone industry is promulgated by the Federal Communications Commission (FCC). Most drones use radio communications in some aspect of their operation. Depending on the power, type, and frequency of the radio transmission, a specialized license may be required. However, transmissions sent on certain unlicensed frequencies, or with specialized equipment, may not require the end-user to obtain special permission from the FCC. To effectively operate at great distances and transmit video back to the operator in real time, drones transmit and receive radio signals at different powers and frequencies, many of which require the operator to obtain special licensing. Less sophisticated products, however, may be pre-certified by the FCC. In some circumstances, FCC compliance may become further complicated due to the FCC's prohibition against certain communications in which the operator has a pecuniary interest.

Consequently, many drone manufacturers may be selling a product that the vast majority of consumers may not operate legally, and many operators may be flying drones without the requisite authorization. Drone operators and manufacturers should pay close attention to new and proposed regulations, but must also be careful not to overlook existing regulatory schemes that may impact this technology in less obvious ways. As with any avant-garde technology, the extent to which the FCC rules will be interpreted remains to be seen.

The War Against Cyber Threats: President Obama Ups the Ante

BY MICHAEL KENTOFF

Focusing on overseas cyber threats, President Obama issued an Executive Order on April 1, 2015, which grants authorization to impose sanctions on individuals and entities engaged "in malicious cyber-enabled activities that create a significant threat to the national security, foreign policy, or economic health or financial stability of the United States." According to President Obama, these "targeted sanctions, used judiciously, will give [the U.S. government] a new and powerful way to go after the worst of the worst."

In a statement made during the signing of the new Executive Order, President Obama specifically identified recent cyber threats from Russia, China, North Korea, and Iran as providing the urgency behind the White House's latest action. While the Obama Administration has – as was the case with North Korea for its attack on Sony in 2014 – sanctioned individuals as a way of punishing foreign regimes, **the new Executive Order, for the first time, provides the U.S. government with the ability to freeze the assets of any individual responsible or complicit in cyberattacks** that pose a significant threat to U.S. national security, foreign policy and economic stability.

While the new Executive Order does not require companies to adopt any specific new protocols, it underscores the need for any entity subject to the Treasury Department's Office of Foreign Assets Control (OFAC) to adopt and keep up-to-date tailored, risk-based OFAC compliance programs. Specifically, businesses engaged in online transactions must do their due diligence with respect to screening OFAC's Specially Designated Nations (SDN) list, which is updated on a regular basis.

The Status of Business Method Patents

BY ETHAN HORWITZ

Business method patents have a checkered history. They were once very much in vogue—numerous such patents issued, and many of them were litigated. Then, about two years ago, Congress enacted a special procedure that made it easier to challenge business method patents in the U.S. Patent and Trademark Office (USPTO). Then, in June 2014, the Supreme Court case *Alice v. CLS Bank* dealt a blow to business method patents. *See* "Patent Eligibility of Software" in the Summer 2014 edition of *Expect Focus*®.

Business method patents raise issues that stem from the basic question: What is allowable as the subject of a patent? The earliest cases held that abstract ideas could not be patented, and that concepts such as accounting methods were not patentable. With the advent of computers, later cases found that business methods implemented by computer programs may not be abstract ideas and could be the subject of a patent. After that, the floodgates opened - both in terms of business patents filed and issued. Such business method patents include industry-specific patents (e.g., how to price an annuity) to generally applicable patents (e.g., the one-click method of buying online).

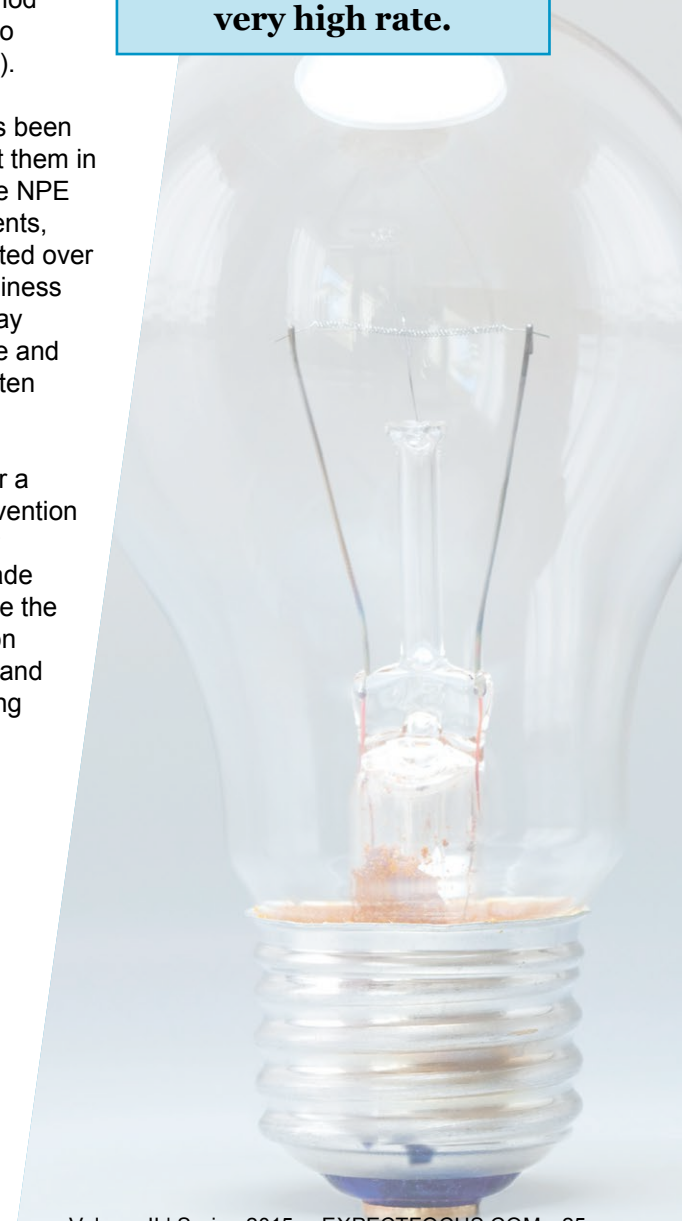
Both the USPTO and courts have been rejecting business method patents at a very high rate.

One consequence of the large issuance of business method patents has been that non-practicing entities (NPEs) have bought patents merely to assert them in litigation. These NPEs, known as "patent trolls" by those who oppose the NPE concept, have filed numerous litigations based on business method patents, creating much controversy. In response, the American Invents Act, enacted over two years ago, instituted a special post-grant procedure to deal with business method patents: a party sued for infringing a business method patent may challenge the validity of that patent in the USPTO. This is less expensive and often faster than using the courts. The more expensive court action is often stayed pending the result of the USPTO proceeding.

More recently, in *Alice v. CLS Bank,* the Supreme Court held a patent for a computer implemented electronic escrow service invalid because the invention was an "abstract idea" and not patentable. The Court did not specifically delineate between an abstract idea and a patentable invention, but it made clear that merely using a computer to perform the method does not make the invention patentable. There have been many complaints that the decision provides no road map regarding the line between patentable inventions and abstract ideas. But courts and the USPTO have interpreted *Alice* as being strongly against patentable business methods.

As a result, *Alice* has had significant consequences, both in the courts and in the USPTO. Not only has the USPTO amended its standards for examining business method patents, but it has been rejecting such applications at a very high rate. The courts have also been invalidating business method patents at a high rate, and very often at summary judgment, early in the case.

While the current status of business method patents looks bleak, these types of patents have made comebacks before, and should not be counted out. In fact, some of the more recent cases provide a glimmer of hope for business method patents. But for now, the pendulum has certainly swung against them.



State Regulation of Virtual Currency: A Recap

BY EDMUND J. ZAHAREWICZ & MATTHEW E. KOHEN

This may be the year of the virtual currency. Virtual currencies have garnered much media, investor, and government attention. But, as venture capital funding continues to pour into the industry—more than $1 billion is expected to be invested this year alone—concerns remain over how the industry should deal with matters such as consumer protection and virtual currency's link to illegal activities. Unsurprisingly, state regulators have taken notice.

The first comprehensive regulatory framework in the United States will likely come from the New York State Department of Financial Services (NYDFS). The latest iteration of the Department's "BitLicense" applies to any entity engaged in a "virtual currency business activity," and would require that entity to register with the NYDFS. The revised BitLicense, however, narrowed the definition of "virtual currency" to exclude gift cards, digital units used solely in online games, and customer rewards programs. "Virtual currency business activity" was also limited, excluding entities that transact in nominal amounts of virtual currency or do so for non-financial purposes.

The revised BitLicense also relaxed, among other provisions, its licensing process and capital reserve requirements. Nevertheless, some industry stakeholders have expressed concern regarding the extent of the BitLicense's recordkeeping and customer identification provisions.

California also introduced virtual currency legislation. The proposed legislation contains a registration requirement similar to the BitLicense, but does not include anti-money laundering or know your customer provisions. However, it would require covered entities to maintain certain "high-quality, investment-grade permissible investments" equal to the sum of the virtual currency maintained on deposit for the licensee's customers.

In late May, the Digital Currency Jobs Creation Act was introduced in New Jersey. The bill would create a regulatory framework similar to the BitLicense, requiring entities that engage in a "digital currency custodial activity" to register with State. While the bill would impose certain cybersecurity, recordkeeping, and capital reserve requirements, it also offers incentives to regulated entities, including tax exemptions.

Commentators expect to see increasing legislative activity in this arena. New laws and regulations will likely have a profound effect on the industry, and should be monitored by interested parties. Given lawmakers' rapidly developing interest in virtual currencies, 2015 may prove to be the defining year for this nascent technology.

Is a "YourBrand.sucks" Domain Name Worth $2,500 per Year?

BY DIANE DUHAIME

The sunrise period for "dot sucks," the new generic top level domain (gTLD), opened on March 30, 2015 and ends on June 19, 2015. During the sunrise period, the suggested retail price per .sucks domain name registration is $2,499 annually. Thereafter, the price remains unchanged for companies that were diligent enough to register their marks with the Trademark Clearinghouse (TMCH) in order to protect them as to newly-introduced gTLDs.

Starting in September 2015, the owners of marks registered with the TMCH will be prohibited from purchasing any .sucks domain names because those marks will only be available to individual consumers who, at an annual cost of just $9.95 per domain name, wish to use .sucks domain names to host forum discussions on the consumer advocate subsidized website, everything.sucks.

Some would argue this sounds like extortion that targets brandowners and uses their money to fund the .sucks registry. However, the International Corporation for Assigned Names and Numbers (ICANN) has blessed the .sucks registration scheme and many brandowners, including oprah.sucks, donaldtrump.sucks and nasdaq.sucks, have already purchased .sucks registrations.

Vox Populi Registry, Inc, a Canadian company, operates the .sucks registry. ICANN's Intellectual Property Constituency submitted a formal complaint to ICANN. As a result, ICANN reported that it sent letters to the U.S. Federal Trade Commission and Canada's Office of Consumer Affairs "asking them to consider assessing and determining whether or not Vox Populi is violating any of the laws or regulations those agencies enforce."

For now, it appears the .sucks registry is here to stay. Therefore, it may be wise for brandowners to monitor the relevant .sucks websites and develop means by which they can interact positively with consumers in an effort to turn complainers into admirers.

Atlanta Shareholder **Catherine M. Salinas** was selected by the U.S. District Court for the Northern District of Georgia to fill the vacancy to be created with the forthcoming retirement of Magistrate Judge E. Clayton Scofield III. She will assume the duties of a United States Magistrate Judge for the Northern District of Georgia on July 1, 2015, following her formal appointment.

Carlton Fields Jorden Burt welcomes the following new attorneys to the firm: Of Counsel **Matthew Z. Leopold** (Government Law and Consulting, Tallahassee) and Shareholder **Barry Leigh Weissman** (Financial Services – Regulatory, Los Angeles). Additionally, the firm recently announced its affiliation with **Greg Deutsch** in Los Angeles, a lawyer who possesses extensive legal experience in the digital media, interactive entertainment and gaming, and technology industries.

Tallahassee Of Counsel **Matthew Leopold** was appointed by U.S. Senators Bill Nelson and Marco Rubio to serve on the Federal Judicial Nominating Commission. The Federal Judicial Nominating Commission performs a public service in recommending candidates to serve as U.S. District Court Judges, U.S. Attorneys, and U.S. Marshals in Florida, and is divided in to three conferences corresponding to each of the three federal judicial districts in Florida. Leopold will serve on the Northern District Conference.

Carlton Fields Jorden Burt Miami Shareholder and past president of The Florida Bar, **Edith G. Osman**, received the "Lifetime Achievement" award from the *Daily Business Review*. This award celebrates the legacy of renowned lawyers and judges who have made a remarkable difference in the legal profession in South Florida.

Hartford Shareholder **H. Scott Miller** was named General Counsel (on a pro bono basis) to Mutual Housing Association of Greater Hartford, Inc. (MHAGH). Miller has served on the MHAGH board of directors for more than six years and most recently he served as MHAGH's president (since 2013). As general counsel, Miller will be MHAGH's chief legal officer, advising MHAGH on pertinent matters germane to its mission of developing, constructing and managing high quality affordable housing in the Greater Hartford area.

"BTI Brand Elite 2015: Client Perceptions of the Best-Branded Law Firms" named Carlton Fields Jorden Burt a leading firm that adds value to the client experience. According to the report, the firm is considered an exception among others as most corporate counsel reported a drop in the number of law firms that add value to the client experience. Carlton Fields Jorden Burt is named as one of two leading law firms who are climbing the "Client Service Strategist" ranks.

In its first ever series on racial diversity in the United States legal industry, *Law360* named Carlton Fields Jorden Burt a top law firm for minority and female attorneys. The firm ranked 2nd for "Top 25 Firms For Hispanic Attorneys," 14th for "Top 100 Firms with Minority Attorneys," and 33rd for "Top 100 Firms with Female Attorneys."

Carlton Fields Jorden Burt ranked number 8 out of 220 law firms in *The American Lawyer's* 2015 Diversity Scorecard. Rankings are based on the percentage of minority lawyers in the firm's U.S. offices and the percentage of U.S.-based minority partners.

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For more information, visit our website at www.CFJBLaw.com.

Atlanta
One Atlantic Center
1201 W. Peachtree Street | Suite 3000
Atlanta, Georgia 30309-3455
404.815.3400 | fax 404.815.3415

Hartford
One State Street | Suite 1800
Hartford, Connecticut 06103-3102
860.392.5000 | fax 860.392.5058

Los Angeles*
2000 Avenue of the Stars
Suite 530, North Tower
Los Angeles, California 90067-4707
310.843.6300 | fax 310.843.6301

Miami
Miami Tower
100 S.E. Second Street | Suite 4200
Miami, Florida 33131-2113
305.530.0050 | fax 305.530.0055

New York
Chrysler Building
405 Lexington Avenue | 36th Floor
New York, New York 10174-0002
212.785.2577 | fax 212.785.5203

Orlando
CNL Center at City Commons
450 S. Orange Avenue | Suite 500
Orlando, Florida 32801-3370
407.849.0300 | fax 407.648.9099

Tallahassee
215 S. Monroe Street | Suite 500
Tallahassee, Florida 32301-1866
850.224.1585 | fax 850.222.0398

Tampa
Corporate Center Three
at International Plaza
4221 W. Boy Scout Boulevard | Suite 1000
Tampa, Florida 33607-5780
813.223.7000 | fax 813.229.4133

Washington, DC
1025 Thomas Jefferson Street, NW
Suite 400 East
Washington, DC 20007-5208
202.965.8100 | fax 202.965.8104

West Palm Beach
CityPlace Tower
525 Okeechobee Boulevard | Suite 1200
West Palm Beach, Florida 33401-6350
561.659.7070 | fax 561.659.7368

* Carlton Fields Jorden Burt practices law in California through Carlton Fields Jorden Burt, LLP.