EXPECTFOCUS®

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What's Cooking?

Industry regulations and reforms on the front burner

JORDEN BURT LLP

EXPECT**FOCUS**® Vol. I Winter 2008

EXPECT**FOCUS**® is a quarterly review of developments in the insurance and financial services industry, provided on a complimentary basis to clients and friends of Jorden Burt LLP.

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IN THE **SPOTLIGHT**

Class Certified in "Revenue Sharing" Case

BY BEN SEESSEL

The District Court for the Western District of Missouri has certified a class of plan participants in a "revenue sharing" case against 401(k) plan sponsor ABB, Inc., ABB employees responsible for plan management and administration, and two Fidelity entities that provide services to ABB's plan. In the action, *Tussey v. ABB, Inc.* (f/k/a *Kennedy v. ABB, Inc.*), plaintiffs allege that defendants breached ERISA fiduciary duties by causing the plan to include investment options with fees and expenses that were unreasonable, excessive, undisclosed, and not incurred solely for the benefit of the plan.

Court says 401K plan participants shared a common interest

The court held that, because all plan participants are interested in seeing the fees at issue returned to the plan, whether the fees were excessive presented a common question of fact and law. Any purportedly varying damages or divergent investment practices were held irrelevant to Rule 23(a)'s commonality and typicality requirements, because plaintiffs are suing on behalf of the plan. In this regard, the court held that it would be for the plan administrator to determine the distribution of any recovery among plan participant class members. The class was certified under Rule 23(b)(1), to avoid the risk of inconsistent or varying adjudications that might create incompatible standards of conduct for defendants as well as adjudications to individual plan participants that might be dispositive of other class members' interests. The court held that the action based on an alleged breach of fiduciary duty to a class of plan participants was "especially appropriate" for certification under Rule 23(b)(1).

RE**FOCUS** *10 years ago in our publication*

California's New Wave of Class Actions (Winter 1998)

Reverse and shared appreciation mortgages enable property owners to cash in a portion of the equity in their property to purchase and annuity or satisfy other financial needs … The usual suspects – class action plaintiff's firms – are now claming that lenders and annuity issuers have engaged in predatory practices concerning these mortgages and that the annuities are overpriced. As a result, a new wave of class-action lawsuits is now hitting California's legal seashores.

Mortgage, annuity and class action issues remain in the news ten years later, and *Expect Focus* has it covered.

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Premium Ratings on Juvenile Insureds
"Standard" Means "Standard"

BY MICHAEL KENTOFF

Standard? I think I'm pretty special!

In so-called "juvenile smoker" litigation, plaintiffs who purchased a life insurance policy on behalf of a minor child commonly allege that in checking the NO box beside the smoking question in a life insurance application, they reasonably expected that the insured would be provided a non-smoker discount premium rating (as opposed to the "standard" rating used industry-wide). Recent federal court decisions have eroded this argument, and the trend continued this past November when the U.S. District Court for the Western District of Pennsylvania, in *Ross v. Metropolitan Life Insurance*, granted MetLife's Motion for Summary Judgment on Plaintiff's breach of contract claim.

The *Ross* decision references the recent "persuasive opinion" of the Middle District of Tennessee in *Thompson v. American General Life and Accident* (see *Expect Focus*, Vol. I, Winter 2007), holding that there exists no obligation on the part of an insurer to provide a specific (non-smoker) rate based on an applicant's statements or affirmations in an insurance application. Given that a "standard" premium rating is not itself ambiguous and that Plaintiffs did "not assert that the rates due and agreed upon are anything other than those clearly stated in the policy," the court held that consideration of the purchaser's expectations or anything other than the contract's plain language was unnecessary.

Decisions like *Ross* and *Thompson* as well a Western District of Pennsylvania decision from earlier in 2007, *Alleman v. State Farm Life Insurance*, provide a clear indication that merely answering a tobacco question in the negative on a life insurance application does not bind an insurer to provide a specific premium rating or to otherwise, as the *Thompson* court observed, "deliver a product it simply does not offer." The allegations in each of these cases simply did not, according to the courts, constitute a contractual breach. "To hold otherwise," the *Ross* court concluded, "would be to create an ambiguity, in order to add a non-existent contractual obligation."

SEC Files Action to Halt Viatical Settlement Ponzi Scheme Targeting Seniors' Retirement Funds

BY EVAN TAYLOR

In another example of the escalating regulatory concern over financial fraud against senior citizens, the SEC recently filed an emergency action to shut down a $25 million Ponzi scheme promising investors safe, secure and profitable interests in viatical insurance settlements without disclosing the dire financial condition of the investment venture. Many of those who participated in the venture were seniors who invested their retirement savings. "Moving to shut down this Ponzi scheme reaffirms the Commission's overall commitment to aggressively investigating and stopping those who prey upon the retirement funds of older Americans," said Linda Chatman Thomsen, Director of the SEC's Division of Enforcement. The Commission's complaint charged the orchestrators of the scheme with violating the antifraud and registration provisions of the federal securities laws, and sought a permanent injunction, disgorgement, and civil penalties.

States Contemplate New Guidelines and Procedures for the Sale of Juvenile Life Insurance

BY WALLY PFLEPSEN & MICHAEL KENTOFF

State regulators are increasingly turning their attention to the sale of life insurance policies on the lives of juveniles, including but not limited to the issue of premium pricing for juvenile insureds.

Drawing up new regulations for juvenile life insurance

In New York, the Department of Insurance recently sent out a draft circular letter asking life insurance companies for feedback regarding the use of smoker and non-smoker mortality tables for juvenile insureds. Historically, life insurers have generally rated juvenile insureds as "standard" in recognition of the fact that mortality tables do not differentiate among juvenile smokers and non-smokers. The "standard" premium rating – different insurers have varying names for this rating – is, in effect, a blended or composite rate that does not provide the discount based on non-smoking history which is often offered to adult insureds. The Department has suggested, in accordance with § 3201(c) of New York's Insurance Law, that insurers be required to underwrite juvenile insureds as non-smokers absent information in their possession that the proposed juvenile insured uses tobacco products. The comments period closed on January 17, 2008.

Another recent rulemaking proposal would require insurers to develop stricter underwriting guidelines for juvenile life insurance sales. In Washington, for instance, a proposal seeks to add teeth to existing legislation by establishing minimum underwriting guidelines and procedures to guard against the purchase of life insurance by adults for fraudulent or speculative purposes. Any legislation in this regard would likely provide for coverage maximums, insurable interest confirmations, and automatic review of applications for juvenile coverage in large sums.

Proposal for Principles Based Regulation

BY BOB SHAPIRO

In early November 2007, New York Insurance Department Superintendent Eric Dinallo released a draft regulation for discussion that would make New York the first state to establish principles based regulation. The proposal contains 10 broad based principles for the insurance industry to adhere to in dealing with the public and its regulators.

"The essential goal of regulation is not rote compliance with a long list of rules, but ensuring appropriate outcomes," Dinallo stated on releasing the draft. One aim of the draft regulation is to reduce unnecessary regulation and require regulated companies and individuals licensed by the Insurance Department to abide by ethical standards.

The draft regulation was discussed on January 18, 2008, at the first meeting of the New York State Commission to Modernize the Regulation of Financial Services, which Dinallo chairs. Although a number of people from the insurance industry have indicated that the proposal has a great deal of philosophical appeal, other industry spokespeople have taken a wait-and-see attitude.

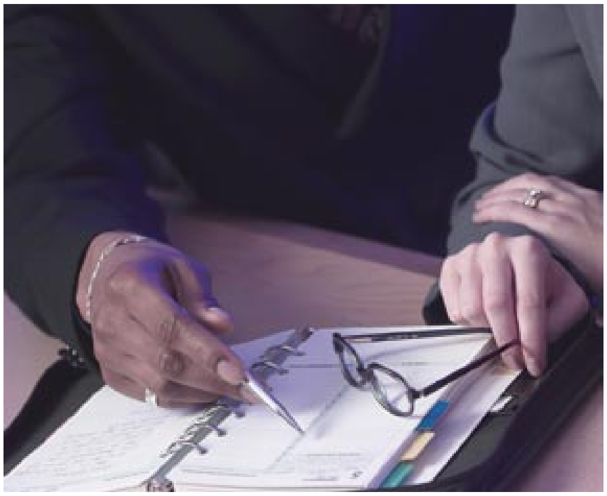
In addressing the issue of whether companies and individuals might be subject to increased liability if the proposed regulation is enacted, Dinallo said, "the principles will not expose companies to additional private lawsuits because New York's Insurance Law generally does not provide for private rights of action. Only the regulator can enforce the principles." Nevertheless, there is a worry about class action suits, particularly in those states where private rights of action are allowed by law.

Whether these principles will create an additional layer of regulation is a concern because the preamble to the proposed regulation states, "These principles do not preempt existing requirements in statute or in regulations." Although the concern of additional regulation was acknowledged by Dinallo, he did indicate that he is "ready to attack" outdated regulations.

New Mortality Table Compliance Date Nears

BY ANN FURMAN

Five years ago, the NAIC adopted a new mortality table, the 2001 Commissioners Standard Ordinary (CSO) Mortality Table. The 2001 Table replaces the 1980 CSO Mortality Table and reflects increases in life expectancy. Insurers are required to use the 2001 Table for purposes of non-forfeiture regulation, which mandates certain minimum policy values, and for establishing policy reserves.



Some life insurers must schedule to file policy forms in 2008

Life insurance companies were permitted to begin using the 2001 Table for policies (including variable life insurance policies) issued after May 1, 2003. The final compliance date for the 2001 Table is January 1, 2009. This means that sales of any current form of variable life insurance policy using the 1980 Table may not be made after January 1, 2009 unless the policy form has been revised to incorporate the 2001 Table and related changes.

During 2008, insurers that have not already filed revised (or new) policy forms with state insurance departments will need to do so. Insurers also must make corresponding changes to their Form N-6 variable life registration statements. The prospectus changes could be minimal or more extensive depending on whether the economics of the policy have changed. In either event, conversions from the 1980 to the 2001 Table will likely result in numerous SEC filings in 2008 by variable life issuers.

Congress Extends Terrorism Insurance Backstop

Other Bills Must Wait for '08

BY MARION TURNER

In one of its final acts before adjourning for the year, Congress cleared a seven-year extension of the nation's terrorism insurance backstop that makes few changes to the existing program, which was set to expire at year's end.

Terrorism insurance was set to expire

House and Senate proposals disagreed over how long to extend the program and whether to expand it to require insurers to include group life insurance and make coverage available for nuclear, biological, chemical or radiological attacks. The House initially sought a fifteen-year extension but settled on the Senate bill's seven-year timeframe. The final agreement also excluded the inclusion of group life insurance and a reduction in the trigger for federal intervention from $100 million to $50 million in losses, supported by smaller insurance companies. The bill calls for a study of coverage for nuclear, biological, chemical and radiological attacks.

Efforts by Property & Casualty and Life insurers to implement an optional federal charter did not materialize this year, as legislation creating one went unaddressed by Congress. *The National Insurance Act of 2007* would allow the insurance industry to function in a manner similar to banks, which can operate either under supervision of states or the federal Office of the Comptroller of the Currency. The bill would establish an independent federal insurance commissioner within the Treasury Department and a consumer protection division under his control. While strongly supported by insurance industry trade groups, the proposal faces significant opposition from the NAIC, as well as the independent agents. Additional Congressional hearings on the matter are expected in the coming year.

Another bill being left to next year would exclude federal taxes on half the income generated by an annuity, up to a maximum of $20,000 annually. *The Retirement Security for Life Act* would provide favorable tax treatment for lifetime annuity payments coming from life insurance death benefits.

Life Settlement Model Act Aims to Prohibit Controversial STOLI Transactions

BY KRISTEN REILLY

On November 17, 2007, the National Conference of Insurance Legislators (NCOIL) unanimously adopted an amended *Life Settlements Model Act*.

Meet your beneficiaries

The model law is intended to provide guidance to states seeking to prohibit controversial stranger-originated life insurance (STOLI) transactions while permitting legitimate life settlements.

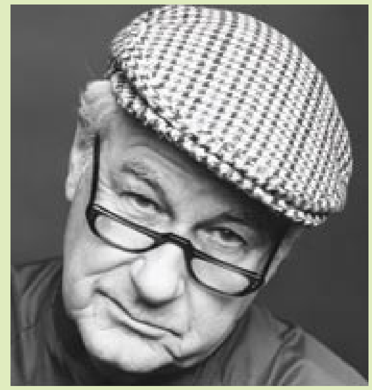
The highlights of the amendments include an unprecedented definition of STOLI, mandatory annual reporting of settled policies to an insurance commissioner, and the disclosure of broker compensation information to policy owners. "By defining STOLI, and strengthening reporting requirements and penalties for participating in STOLI," NCOIL's Life Settlements Subcommittee chair stated, "the NCOIL model gets at the heart of what needs to change." The amended Life Settlements Model Act is available at *http://www.insurereinsure.com*.

The National Association of Insurance Commissioners also recently considered changes to its Viatical Settlements Model Act, pursuant to which life policies could not be re-sold within five years of their issuance. Some states currently impose a two-year prohibition.

Annuity Litigation and Enforcement Action Update

BY JASON GOULD

The latter months of 2007 continued to see the proliferation of investigations and lawsuits by state attorneys general concerning allegedly improper deferred annuity sales practices. Some of the investigations and enforcement actions involve the companies' general advertising and marketing of deferred annuities, while others focus on the sale of deferred annuities to senior citizens.



Litigation focuses on seniors

Meanwhile, the various putative nationwide class actions involving the sale of deferred fixed annuity products to seniors, which have been previously reported (see *Expect Focus*, Vols. II & III, 2007), continue to drag on in the courts without significant new developments. Many of the courts have recently extended briefing schedules on dispositive motions and motions for class certification. In addition, the court in the *Yokoyama v. Midland National Life Ins. Co.* proceeding recently granted Plaintiffs' request to defer ruling on defendant's motion for summary judgment pending Plaintiffs' appeal to the U.S. Court of Appeals for the Ninth Circuit of the district court's June 21, 2007 Order Denying Class Certification. *Expect Focus* will continue to monitor and report on developments in these matters in 2008.

Congratulations!

Jorden Burt Attorneys Participate in ABA-TTIPS

The American Bar Association Tort and Insurance Practice Section's Life Insurance Law Committee honored **Shaunda Patterson-Strachan** with an award for her year of service as chair of the committee. Partner **Sheila Carpenter** and associate **Robin Sanders** continue as vice-chairs of this ABA-TTIPS committee.

Legal Storm Brewing Over Insurers' Alleged Claim-Payment Fixing Scheme

BY JOHN PITBLADO

Louisiana's Attorney General recently filed suit against several property insurers, including Allstate Insurance Company, State Farm Fire & Casualty Company, Farmer's Insurance Exchange and Standard Fire Insurance Company, alleging that the insurers conspired and colluded among themselves, and with co-defendants Xactware, Inc., Insurance Services Office, Inc. (ISO), and McKinsey & Company Inc., to artificially reduce the value of property claims by manipulating a claim database used as an industry reference.

The alleged scheme emanates from the so-called "McKinsey Principle"—purportedly devised by defendant McKinsey & Company, a corporate consulting firm—and involves undervaluing claims by, according to the suit, "the tactics of deny, delay, and defend." This principle allegedly motivated a scheme to manipulate claims payment information in an industry database to reflect lower payouts on claims in the market, and was achieved through the cooperation of participating insurers with access to alter the database. The database was allegedly devised by Xactware, Inc., a company later acquired by defendant ISO, which touts the database and the savings it affords client insurers.

The complaint alleges that, "[a]n agreement, combination or conspiracy … [existed to] fix the prices of repair services utilized in calculating the amount(s) to be paid under the terms of Louisiana insureds' insurance contracts." The suit specifically alleges evidence of collusion: "State Farm's price list [of market claims payment information], active on or about November 15, 2005, upon information and belief, was identical to Traveler's price list … , active on or about November 15, 2005; with each price list containing over 10,000 line items, this is a statistical impossibility without collusion."

Piggybacking on the tragedy of Hurricane Katrina, the complaint asserts that "[t]he combination and conspiracy between and among Defendants … has greatly impeded the ability of the entire state to recover from the devastating effects of Hurricanes Katrina and Rita." Stay tuned for the latest Gulf Coast legal storm.

Courts Say "NO" to Katrina Class Claims

BY BEN SEESSEL

The court struck plaintiffs' class allegations in *Henry v. Allstate Insurance Co.*, a putative class action brought on behalf of Louisiana policyholders who suffered damages in Hurricanes Katrina and Rita. Plaintiffs brought claims for breach of contract, bad faith, and fraud alleging that Allstate depressed claims values by using a software package called IntegriClaim. The court held that, while Allstate's use of IntegriClaim might be common to all putative class members, proving Allstate's purported pattern and practice of undervaluing claims would require an "intensive" review of individual facts, including the extent of each class member's damage claim, the adjustment of each claim, and how much of each claim was paid, such that individual issues would "patently overwhelm" common ones.

In a similar holding, the court in *Caruso v. Allstate Ins. Co.*, struck the class allegations from a complaint filed under Louisiana's Valued Policy Law on behalf of a putative class of Louisiana homeowners who suffered losses from Katrina's winds. The court struck plaintiffs' Rule 23(b)(3) class allegations, holding that the claims would entail "highly individual" inquiries under Louisiana's VPL, including proof of the proximate cause of each plaintiff's total loss and the amount of damage allegedly sustained, rendering their claims inappropriate for class treatment. The court also struck the class allegations under Rules 23(b)(1) and (b)(2), holding, among other things, that individualized damage claims are inappropriate for certification under these provisions.

Homeowner's Policy Still Not Ambiguous

BY ELEANOR MICHAEL

In yet another recent case arising out of the destruction brought by Hurricane Katrina, the Fifth Circuit Court of Appeals upheld a homeowner insurer's decision to deny a claim for damage to a residence caused by the storm. Relying heavily on *Leonard v. Nationwide Mutual Insurance Company*, the court in *Tuepker v. State Farm Fire & Casualty Company*, concluded that the lack of a specific reference to a "storm surge" in the policy's Water Damage Exclusion provision did not render the policy ambiguous or allow the insured to recover for losses. The court also held that the anticoncurrent-causation clause (ACC clause) was also not ambiguous under Mississippi law, as it could not be construed to have two or more reasonable meanings. The court explained that any damage caused exclusively by a covered peril such as wind, and not concurrently or sequentially with water damage, is covered by the policy. However, where damage is caused by water or wind acting concurrently or sequentially with water, it is excluded.

The policyholders also argued that the "Efficient Proximate Cause Doctrine" should apply. That doctrine states that when a loss is caused by both covered and excluded perils, the loss is covered if the risk was proximately caused by the loss. For example, if a policy covers wind damage but not water damage, the insured may recover if it can be shown that the wind proximately caused the loss. The court disagreed, and held that the ACC clause trumps the Efficient Proximate Cause Doctrine.

Revving up the Motor Vehicle Exclusion

BY JOHN PITBLADO

Most standard form homeowners policies contain an exclusion of coverage for liability arising from the use of motor vehicles, including recreational motor vehicles. However, most also contain an exception to the exclusion for recreational motor vehicles used on the "residence premises" or "in connection with" the residence premises. In case of liability arising from recreational vehicle use near and around – but not on – the "residence premises," the question is often what use "in connection with" a residence premises means.

A number of federal and state appellate decisions have addressed the issue, often with a focus on the legal relationship in terms of property interest, between the policyholder and the "premises" upon which the liability arises, and whether the policyholder has some legal right – such as an easement – to use the premises. A recent case from the Federal District Court in the District of Connecticut provides a fresh approach to analyzing the issue, in a case where the insured pointed to evidence of its right to use the premises in question (a private roadway in the insureds' private homeowners association).

Court focuses on the nature of the insured's property use

In *Royal Indemnity Co. v. King*, the court noted that "[t]o determine whether insureds use a piece of property in connection with their residence, a court must consider the nature of the insureds' use of the property. The inquiry is fact-intensive." Thus, rather than focusing on the nature of the insureds' legal claim of right to use the premises, the court instead examined the insureds' "actual use" of the premises in question, finding the insureds' demonstration of such to be a "prerequisite" to establishing coverage. Finding no demonstration of actual use, the court granted summary judgment to the insurer. A notice of appeal to the Second Circuit Court has been filed.

Washington Voters Approve Insurance Fair Conduct Act

BY BEN SEESSEL

As previously reported, Washington state passed the Insurance Fair Conduct Act, creating a statutory cause of action on behalf of first-party insureds faced with purported unreasonable claims delays and denials. The act was scheduled to take effect this past summer, but opponents succeeded in having the would-be law put to a statewide vote. Voters passed the law in November. Accordingly, Washington insurers are now subject to possible treble damages where claims are delayed or denied, as well as mandatory attorneys' fees and costs awards, including expert witness fees.

"Modern Times" for U.S. Reinsurance Regulation?

BY ANTHONY CICCHETTI

Recent action by the NAIC confirmed its aim to reform reinsurance regulation in the United States. At the NAIC's winter national meetings in Houston, the Reinsurance (E) Task Force voted to adopt a framework memorandum setting forth a "Reinsurance Regulatory Modernization Proposal." The Financial Condition (E) Committee approved the Task Force's report at the conclusion of the winter meetings.

Reinsurance regulation: modern if not stylish

Originally exposed in November 2007, the memorandum proposes a framework premised on (1) mutual recognition agreements with non-U.S. jurisdictions, and (2) a single-state regulator for all reinsurers doing business in the United States. The "mutual recognition" element contemplates the creation of a Reinsurance Supervision Review Department within the NAIC, which would apply an "outcomes-oriented" approach to assess regulatory effectiveness in non-U.S. jurisdictions and determine non-U.S. jurisdictions appropriate for mutual recognition agreements. The "single state regulator" feature of the framework seeks to eliminate inappropriate extraterritorial regulation of a U.S. domestic reinsurer by allowing it to access U.S. markets upon obtaining certification by its state of domicile or another U.S. regulator. Foreign reinsurers similarly would qualify to access U.S. markets by obtaining certification from a single, "port-of-entry" U.S. jurisdiction.

How quickly such reform can become reality remains to be seen. The memorandum identified more than a dozen general issues requiring further discussion and analysis. Establishing appropriate and consistent collateral requirements for both domestic and foreign reinsurers doing business in the United States – the long-standing issue that triggered the more comprehensive analysis of reinsurance regulatory reform – continues to top the issues list. The previously proposed ratings-based approach remains the foundation for contemplated reform of the collateral requirements.

NY Proposes Regulation to Attract Capital

BY BOB SHAPIRO

New ideas to attract capital to New York

The New York Insurance Department issued a proposed regulation changing the way in which some New York domiciled insurance companies can obtain statutory financial statement credit for reinsurance ceded to unauthorized and non-accredited reinsurers. Under the proposal, if adopted, well capitalized non-U.S. domiciled reinsurance companies with the highest credit rating from two recognized credit rating agencies would be treated the same as New York domiciled reinsurers without being required to post collateral. Under current regulations, reinsurers not authorized or accredited to transact insurance in New York are required to post collateral for 100% of the share of liabilities ceded to them in order for the ceding insurer to obtain financial statement credit. In announcing the proposed regulation, which is intended to take effect on July 1, 2008, Superintendent Dinallo stated that the new regulation "will help attract more capital to the New York reinsurance market."

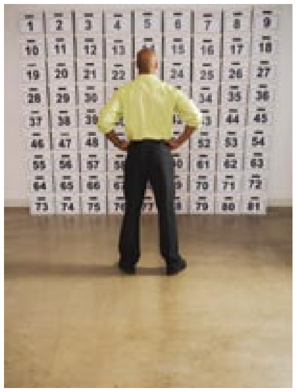
Key points of the proposal would allow unauthorized and unaccredited reinsurers with a triple A credit rating from two rating companies to post no collateral. Those reinsurers with a double A or equivalent rating would have to post collateral equal to 10% of liabilities, single A 20%, and triple B rated reinsurers would post 50%. In addition to the credit rating requirements, another part of the proposed regulation would require reinsurers to maintain policyholder surplus in excess of $250,000,000 in order to qualify for no or reduced collateral.

The proposal has been circulated to the insurance industry and will then go through a formal process of publication in the New York State Register followed by a 45-day comment period for written comments.

Sundays and Holidays Count When Calculating Deadline

BY ROLLIE GOSS

In *Certain Underwriters at Lloyd's v. Argonaut Ins. Co.*, the U.S. Court of Appeals for the Seventh Circuit has held that time deadlines in arbitration agreements must be strictly enforced, affirming a District Court decision that deprived a party of the right to appoint an arbitrator. Argonaut, a California-based insurer, missed the deadline for appointing one of the arbitrators in an international arbitration, when the deadline fell on the Sunday of Labor Day weekend, and it submitted its appointment on the day after Labor Day. When Argonaut did not appoint its arbitrator, Lloyd's appointed an arbitrator for that position on the panel, giving it two party-appointed arbitrators. Argonaut argued that in light of the holiday, the notice it gave was a "timely nomination" of the arbitrator. The court disagreed, holding that "[i]n the absence of a choice-of-law provision, we conclude that parties are to be bound to the explicit language of arbitration clauses, with no state-specific exceptions that would extend otherwise clear contractual deadlines."



Day Late, Opportunity Lost

BY ROLLIE GOSS

An arbitration award was entered against Webster under the rules of the American Arbitration Association (AAA). Under the Federal Arbitration Act (FAA), 9 U.S.C. § 12, when a party moves to vacate, confirm or modify an arbitration award, notice of the request must be served within three months after the award is filed or delivered. The district court found in *Webster v. A.T. Kearney, Inc. & Electronic Data Systems Corp.*, that Webster's attempt to vacate the award was one day late, and hence barred, and the Seventh Circuit affirmed. The courts held that the award was "filed or delivered" within the meaning of the FAA and the AAA's rules when it was both e-mailed and mailed by the arbitrator to counsel for the parties, regardless of when counsel received the mailed version or opened his e-mail. A request to vacate an award is a motion, rather than a new action, under the Federal Rules of Civil Procedure, and the plain language of section 12 of the FAA speaks in terms of "service" rather than "filing." Since Webster's counsel filed a Complaint seeking to vacate the award one day prior to the three-month deadline, but did not serve the action until one day after the three-month deadline, the request to vacate the award was untimely under the FAA. The Court rejected Webster's argument that the FAA's limitation period was tolled with the filing of the action, stating instead that there was "nothing ambiguous about § 12's provision that the statute of limitations is tolled when notice of a motion to vacate is 'served upon the opposing party or his attorney.'" This is a critical principle for parties seeking to vacate or confirm an award under the FAA.

IRS Proposes Tax Changes for Captives

BY LYNN HAWKINS

The IRS has proposed that tax rules be changed as to when captives can take deductions on reserves established for incurred losses. Currently, captives are permitted to take an immediate tax deduction for reserves established to pay for incurred losses of affiliated companies. However, the proposed regulation would defer the tax deduction for an incurred loss arising from related party business until it is actually paid. The proposal, which caught the industry by surprise, would affect single parent captives (including foreign captives that have elected under Code Section 953(d) to be treated as domestic insurers for US tax purposes) filing a consolidated tax return with its parent. There is concern among the US insurance regulators that this would eliminate an important tax incentive for US domiciled captives, resulting in captives moving offshore.

According to a "Frequently Asked Questions" bulletin issued by the Captive Insurance Companies Association and the Vermont Captive Insurance Association, the cost to captives will depend on "the lines of business written and whether (and how) the taxpayer decides to restructure." The bulletin notes that, "The effect of the regulation is to defer the deduction for losses until they are actually paid, so the tax detriment is the present value of the difference between a current deduction for discounted loss reserves and a future deduction for paid claims."

Foreign captives (which have not elected to be treated as domestic for US tax purposes), risk retention groups, and captives writing 95% unrelated business generally will not be affected.

NOTE**WORTHY**

ERISA

More Money Managers Face Subprime Lawsuits

BY RICHARD CHOI & STEVE GOLDBERG

The meltdown of the U.S. subprime mortgage market continues to generate litigation against money managers and their affiliates. On January 25, 2008, Israel Discount Bank (IDB) filed a lawsuit against BlackRock, Inc. (BlackRock) and Metropolitan Life Insurance Company (MetLife), alleging breaches of contract and fiduciary duty in connection with an investment in a MetLife COLI policy that included a BlackRock managed investment fund. IDB allegedly incurred losses of approximately $2 million from the investment fund's exposure to subprime mortgage-backed securities and MetLife's alleged refusal to honor IDB's demand that its investment be placed elsewhere.

On January 14, 2008, a purported class action lawsuit was filed against State Street Global Advisors, Inc. (State Street) on behalf of certain retirement plans alleging violations by State Street of ERISA fiduciary obligations in connection with investments of plan assets in certain bond funds that allegedly deviated from their stated investment strategies by their overexposure to securitized subprime home equity loans. This lawsuit follows on the heels of Prudential v. State Street, an individual action, and Unisystem v. State Street, a purported class action, both filed in October 2007.

On December 12, 2007, a purported class action lawsuit was filed against Morgan Asset Management, Inc. (Morgan) on behalf of persons who purchased shares of two mutual funds managed by Morgan. The complaint includes allegations of disclosure and other violations of the federal securities laws, including the Investment Company Act of 1940, in connection with investments in "relatively new" and "untested" fixed income securities that allegedly were adversely affected by the subprime crisis. Other named defendants include directors and officers of the funds (including the funds' chief compliance officer), the funds' distributor, and the funds' outside auditor.

Recent commentators have suggested a likelihood of further similar litigation involving financial institutions, both as plaintiffs and as defendants.

Pro Bono Corner

BY SHEILA CARPENTER

In the past year, Jorden Burt attorneys have acted as guardians ad litem for children who are neglected or the subject of a custody dispute, prosecuted a suit against a major apartment developer for failing to build housing accessible for the disabled in violation of the Fair Housing Act, prosecuted suits on behalf of two families involved in mortgage "foreclosure rescue" schemes, helped a victim of domestic violence obtain a protective order against her abusive boyfriend, appealed Social Security's termination of benefits for a disabled child and appealed the denial of benefits to a veteran. Recently we have taken a criminal appeal for an impoverished prisoner and come to the aid of a deaf man who alleges that a used car dealer sold him a lemon.

The Pro Bono Hero of the Year award goes to Rollie Goss who has taken on his third and fourth adoption cases in D.C.'s Superior Court. The second adoption is still ongoing, involving a foster mother who wants to adopt a child she has been caring for since birth. The 13-year old mildly retarded birthmom has complicated matters by naming a string of men as potential fathers at each successive hearing. However, permanency is in sight early 2008. The foster mom is so pleased with Goss's work, assisted by Patrick Lavelle, that she has asked us to assist her with the adoption of two more foster children in her care. Goss along with Todd Willis will pursue permanency for these children.

Variable Product Disclosure Reform

BY GARY COHEN

The SEC has proposed disclosure reform for mutual funds. This reform provides for important—even momentous—changes in the process of delivering disclosure. Funds can deliver 3 or 4-page summary prospectuses and, unless a person requests, never deliver a paper statutory prospectus.

In proposing disclosure reform for funds, unsurprisingly, the SEC said nothing about disclosure reform for separate accounts and variable insurance products. The SEC is following a pattern that it has followed in the past: first addressing an issue for non-funds, then for funds and finally for separate accounts. The SEC's plain-English initiative is a prior example of this SEC regulatory pattern.

The SEC might take a while to get to variable products

The SEC has never felt completely comfortable about regulating variable insurance products. Individual commissioners usually have not had direct experience with the products. Commissioners and staff officials have said in speeches to the effect that they do not fully understand the products or the disclosure of the products.

The SEC's mindset is understandable. The federal securities acts, as originally adopted, did not address variable insurance products. Congress has amended the acts, and the SEC has adopted rules to address certain products. But the SEC still has been forced to hustle to keep up with continuing industry innovation and creation of new products and product features.

A number of SEC staff members have extensive knowledge of, and experience with, variable insurance products, but has been hesitant to recommend that the Commissioners codify practice and lore. Given the pace of industry innovation the staff may fear that it could codify a loophole.

Whatever the reason, SEC reform of regulation of variable insurance products has lagged. For example, the SEC took 29 years to adopt the Form N-6 Registration Statement for variable life insurance after the SEC first announced it would do so. And the SEC has not yet updated the variable life insurance exemptive rules currently on the books to reflect the amendments to the Investment Company Act that Congress adopted 11 years ago.

The SEC is following its traditional pattern in the context of disclosure reform. In 2005, the SEC adopted so-called "securities offering reform rules" for non-funds. In doing so, the SEC expressly stated—even emphasized—that it would next tackle disclosure reform for funds. Now, two years later, the SEC is doing so.

A significant difference in this case, the SEC's proposing release for disclosure reform for funds says nothing about any SEC intention to next take up disclosure reform for separate accounts and variable insurance products. In 2007, life insurance companies can't tell whether the SEC will be addressing their situation anytime soon.

Changes Expected for Controversial NY Exam Letter

BY CHIP LUNDE

The SEC staff is planning changes to the controversial "pilot" New York examination letter before rolling it out nationwide.

Last fall, the SEC's New York Regional Office began using a new exam template with expanded questions aimed at uncovering insider trading issues. The new exam letter was prompted, in part, by reports of increased trading in shares and options of issuers prior to takeover announcements, and by a congressional investigative report noting the need for improvements in the SEC's management of enforcement investigations.

Among the more criticized questions in the New York exam letter is the request for a list of the adviser's clients, employees, and relatives of employees who serve as officers or directors of publicly traded companies. The New York letter also requests summaries of deals or arrangements that "the Adviser was asked to consider but rejected because the proposal was deemed inadvisable, inappropriate, unethical, or possibly illegal," otherwise known as the "bad thoughts log."

The industry has criticized the letter as being too lengthy, too broad, and for requesting information advisers were not legally required to collect and retain. John Walsh, associate director and chief counsel at the OCIE addressed industry concerns on December 7, 2007 at the ICI's Securities Law Developments Conference in Washington, DC. Walsh stated that the staff was reviewing the New York "pilot" letter in Washington before using it in other regional offices. He described four likely changes to the letter.

1) The new letter will be shorter (from approximately 30 to between 10 and 20 pages).

2) The staff will use a two-step approach. First it will ask firms to tell the staff what they're doing to address insider trading risks. If the staff is not satisfied with the answer they will follow up with the more detailed request for information.

3) Advisers may choose to respond in writing or orally.

4) Certain topics are being withdrawn. In particular, the "bad thoughts log" will be removed.

NY Exam letter asks advisers to keep "bad thoughts logs"

SEC Grants Relief from Custody Rule

BY SARAH JARVIS

In a recent letter to the Investment Adviser Association, the SEC staff granted no-action relief from Section 206(4) of the Advisers Act and the "Custody Rule" thereunder, where an adviser inadvertently receives client assets from a third party and the adviser promptly forwards such assets to the client or a qualified custodian. Such a situation does not subject the adviser to compliance with the Custody Rule as long as the assets are sent to the client or returned to the third party within five days of receipt by the adviser.

The no-action letter contemplates that client assets received from third parties should not be returned to the third party sender because the third party would not be deterred from sending client assets to the adviser, it may cause delay in the client receiving the assets, and the third party may not have fiduciary duties to the client, thus jeopardizing the assets.

SEC Sanctions Adviser Using "Off the Shelf" Compliance Program

BY KAREN BENSON

Advisers who purchase "off the shelf" compliance programs that are not tailored to their business are at risk of violating the compliance program rule. The SEC brought its first enforcement action against a registered investment adviser, Consulting Services Group LLC, and its chief compliance officer for failure to adopt and implement an adequate compliance program.

Off the shelf compliance programs need remodeling to avoid sanctions

According to the SEC's findings, the CCO purchased an "off the shelf" compliance program that was designed for use by advisers offering discretionary money management services to non-institutional clients. The firm, however, provided discretionary money manager search and selection and other services primarily to pension fund clients. The SEC found that the compliance program failed to address adequately the risk factors and conflicts of interest that were unique to the firm's operations as a pension consultant, and that many of the sections within the compliance program were completely inapplicable and irrelevant to the services the firm offered to clients.

The firm and its CCO were also sanctioned for failure to timely adopt and accurately document a code of ethics. The SEC found that the firm failed to timely adopt a code of ethics, and that the CCO instructed the firm's supervised persons to backdate their written acknowledgement forms so as to falsely indicate that the firm's code of ethics had been timely adopted.

The SEC concluded that the firm willfully violated Advisers Act Sections 204 and 206 and Rules 204-2, 204A-1, and 206(4)-7 thereunder, and that the firm's CCO willfully aided and abetted and caused such violations. Without admitting or denying the SEC's findings, the firm and its CCO agreed to settle the action and pay civil penalties of $20,000 and $10,000 respectively. The CCO was also permanently barred from serving in a compliance capacity with any broker-dealer or investment adviser.

The relief allows an adviser to forward assets inadvertently received to the client only if the assets are (i) received from a tax authority in connection with administrative tax filing services provided to the client; (ii) settlement proceeds received from an administrator of funds in connection with a legal action where the adviser files or completes the related documentation for the client; or (iii) stock certificates or dividend checks in the name of the client. Additionally, the relief is limited to situations where the adviser has no control over the third party, has used its reasonable best efforts to direct third parties to deliver client assets to its client and has not directly or indirectly caused the third party to deliver the client assets to it. Advisers that inadvertently receive client assets "in more than rare or isolated instances" must also implement certain policies and procedures to ensure that such assets are promptly identified and forwarded to the client.

Clients will smile when assets are promptly forwarded

DOL Requires Expanded Disclosure Of Plan Fees

BY STEVE KRAUS

Plan administrators must report compensation of $5,000 or more

The Department of Labor recently finalized revisions to the Form 5500 Annual/Return Report that ERISA covered plans are required to file. The revisions are generally effective for the 2009 reporting year.

The most significant revision is the expanded disclosure of compensation received by service providers to be reported on Schedule C (Service Provider Information). Schedule C requires plan administrators to report compensation (direct and/or indirect) of $5,000 or more received by each service provider. Service providers who fail to provide the requested information will be identified on the Schedule C.

Direct compensation includes payments by a plan out of a plan account and charges to plan participants' accounts. Indirect compensation includes fees and expense reimbursement payments received by a service provider from mutual funds, banks, insurance companies, pooled investment funds and other separately managed accounts that are charged against the fund or account (e.g., fees paid by a mutual fund to its investment adviser, sub-transfer fees, account maintenance fees, and 12b-1 fees). Indirect compensation also includes finder's fees, float revenue, brokerage commissions, and research or other products or services received from a broker-dealer or other third party in connection with securities transactions (soft dollars).

An alternative reporting method is provided in the case of bundled service arrangements for service providers who receive only "eligible indirect compensation." Instead of having to report specific dollar amounts, a service provider can provide disclosure to the plan administrator of: (1) the existence of the indirect compensation; (2) the services provided for the payment of the indirect compensation; (3) the amount (or estimate) of the compensation or a description of the formula used to calculate or determine the compensation; and (4) the identity of the party or parties paying and receiving the compensation.

Announcing

Five Attorneys Join Jorden Burt

Jorden Burt is pleased to announce the arrival of five attorneys. **John Pitblado** started in the Connecticut office as an associate. In Miami, two associates, **Aram Bloom** and **Richard Sahuc**, joined the firm. **Anthony Lalla** started in the Washington office in November as an of Counsel, and **Kristen Reilly** joined the Washington office as an associate. More information on the attorneys can be found at *www.jordenburt.com.*

Continued Consumerist Pressure on Arbitration Practices

BY TOM LAUERMAN & MARION TURNER

FINRA has recently referred rule changes for SEC approval that would substantially curtail broker-dealers' ability to obtain dismissal of an arbitration proceeding before a claimant finishes presenting its case. Although motions for such summary dismissals have often been filed by broker-dealer firms, as previously reported (see *Expect Focus*, Vol. III., Fall 2006) the circumstances under which arbitration panels should grant such relief have been subject to uncertainty and controversy.

Arbitration: tougher climb for broker-dealers

Under FINRA's proposal, a dismissal motion could be granted before a claimant has finished presenting its case only if:

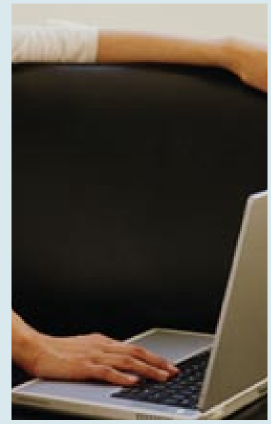
- The parties have settled their dispute,
- It was factually impossible for the moving party to have been associated with the conduct at issue, or
- The applicable 6-year limit on submission of arbitration claims has expired.

Further, arbitrators would be required to hold a hearing on the motion, and any decision to grant the motion would be required to be unanimous and accompanied by a written explanation. Also, if the hearing panel denies the motion, the moving party would be assessed all forum fees associated with the hearing on the motion.

We also previously reported on pending legislation that could prohibit broker-dealers (among others) from requiring their customers to enter into agreements that bind them to arbitrate future disputes (see *Expect Focus*, Vol. IV., Fall 2007). Subsequently, hearings have been held in both the House and Senate on that pending legislation (H.R. 3010/S. 1782). Most witnesses favored curtailing such agreements to arbitrate. A notable exception, however, was Peter B. Rutledge, a law professor at Catholic University. He argued, among other things, that nearly all available studies show that the party with the weaker bargaining position actually achieves a better (or at least comparable) outcome in arbitration, as compared to litigation.

SEC May Reinstate Terrorist-List Web Tool

BY KAREN BENSON



The SEC may reinstate its web tool that assists investors to identify companies with business activities in or with countries the U.S. State Department has designated as state sponsors of terrorism. The information about such activities comes from the companies' most recent annual reports filed with the SEC.

The SEC suspended the web tool in July 2007, after receiving negative comments regarding the tool's inability to access information more current than the date of a company's most recent annual report. Other concerns included that the negative connotation for a company identified through the web tool could be unfair in some cases.

To address such concerns, the SEC has recently solicited input on two proposals to provide improved access to companies' disclosures concerning their business activities in or with state sponsors of terrorism. One proposal would simply enhance the web tool by, for example, including a company's most recent SEC filings to ensure more current information. An alternative proposal is to create interactive data tags in XBRL language, which companies could apply to disclosures they make regarding business activities in or with state sponsors of terrorism, without the need for a web tool. If the SEC were to pursue the alternative proposal, the agency has asked whether the use of XBRL data tags should be voluntary or mandatory for companies.

Summary Fund Prospectuses—Implications For Life Insurance Companies

BY GARY COHEN

Proposed reforms raise more questions

The SEC, in a November 2007 release, has proposed mutual fund disclosure reform, including a streamlined 3 to 4 page summary prospectus and elimination of delivery of a paper statutory prospectus (unless requested).

The proposal has implications for life insurance companies investing separate account assets in underlying funds. First, life companies marketing variable insurance products would be able to deliver summary prospectuses for underlying funds. The conditions for relying on the proposed rules refer to the use of a fund summary prospectus with a "variable contract as defined in section 817(d) of the Internal Revenue Code."

Second, there could be a situation where a life company wants to deliver an underlying fund's summary prospectus, but the fund refuses. A fund might not want to bear the cost and effort of updating the summary prospectus quarterly or risk liability for not delivering a full prospectus.

Third, the proposal is not clear on whether a life company's delivery of an underlying fund's summary prospectus can vary with the circumstances. For example, could a life company deliver full prospectuses to new offerees, but summary prospectuses to existing owners?

Moreover, the proposal is not clear regarding electronic access to the full prospectus that the proposal requires the fund to maintain on its website. For example, could a life company maintain the full underlying fund prospectus on the life company's website or hyperlink to the full prospectus on the underlying fund's website?

These matters (as well as others) could require amendments to existing agreements under which insurance companies participate in underlying funds. The deadline for comments on the SEC's proposal is February 28, 2008.

FINRA to Update Variable Product Communication Requirements

BY ANN FURMAN

As anyone who has prepared or reviewed variable insurance product sales material knows, FINRA Advertising Regulation's content standards and interpretive positions are not always clearly articulated. One common problem, for example, is that broker-dealers distributing and selling variable products may receive comments on sales material based on unwritten FINRA staff positions.

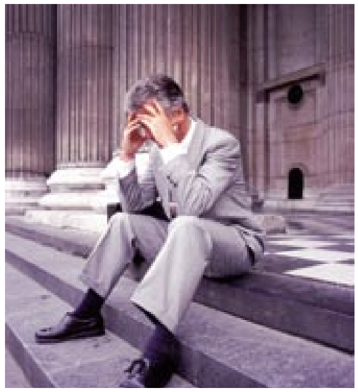
FINRA's written *Variable Contract Communication Guidelines* were created in 1993. Since that time, FINRA also has issued guidance in the form of Notices to Members, Regulatory Alerts, Ask the Analyst responses, and other interpretive commentary. These sources can be difficult locate and use. Among other things, they were published at different times and for different purposes, are not comprehensive, and contain inconsistencies.

At a recent industry-wide conference, a FINRA Advertising Regulation staff member announced from the podium that FINRA is currently in the process of updating the *Variable Product Communication Guidel*ines in order to consolidate written and unwritten guidance and make other updating changes. This is welcome news for the industry. Among other things, revised Guidelines are expected to address various forms of variable product illustrations. FINRA has solicited suggestions from the industry. Once the revised Guidelines are drafted, FINRA intends to submit them for review and comment to various FINRA committees and eventually to the public. FINRA hopes this will take place in 2008.

Fixed Indexed Annuities
Litigation and Enforcement Trends

BY SHAUNDA PATTERSON-STRACHAN & ERIC COMBS

Indexed annuities continue to be a target of litigation, frequently with allegations of unsuitability for seniors. Plaintiffs' counsel now seem to believe that focusing on product features gives them the best chance of getting their suits certified as class actions. Thus, the trend is away from claims explicitly predicated on point-of-sale misrepresentations, and toward theories purportedly based on product design and unsuitability.



Recent trends frustrating to broker-dealers

Despite some success by plaintiffs in such cases, the courts have not always agreed that class certification is appropriate. *Yokoyama v. Midland Life Ins. Co.*, alleging violations in targeting seniors for the purchase of indexed annuities, has involved two failed class certification efforts. Most recently, despite the plaintiffs' assertion of an "inherently unsuitable for seniors" theory, the court denied class certification in part because suitability claims had to be "adjudged individually." The ruling is now on appeal before the Ninth Circuit. Issues regarding the merits of this type of lawsuit have been hotly contested, with motions to dismiss various types of claims having received mixed results to date.

Though fixed indexed annuities are generally not considered to be "securities," FINRA and the SEC also have these products on their radar screens. Thus, FINRA has conducted "sweep" examinations of brokers-dealers who recommend that their clients sell securities to buy indexed annuities. FINRA also has initiated enforcement actions against registered representatives for misconduct in the manner in which fixed indexed annuities were sold. For example, a registered representative was recently sanctioned for using presentations promoting the sale of fixed indexed annuities to retirees that contained, inter alia, guarantees that the retirees would never run out of money.

The SEC has also recently brought an action against a registered representative, Mark Teruya, that demonstrates the SEC's continuing interest in this area. The SEC alleged that Teruya defrauded seniors and garnered $2 million in commissions by deceptively obtaining their personal information, selling their existing securities holdings without their knowledge, and using the proceeds to purchase fixed indexed annuities.

FINRA Guidance on Rule 2821
Proposes Delay of Principal Review Requirement

BY RICHARD CHOI

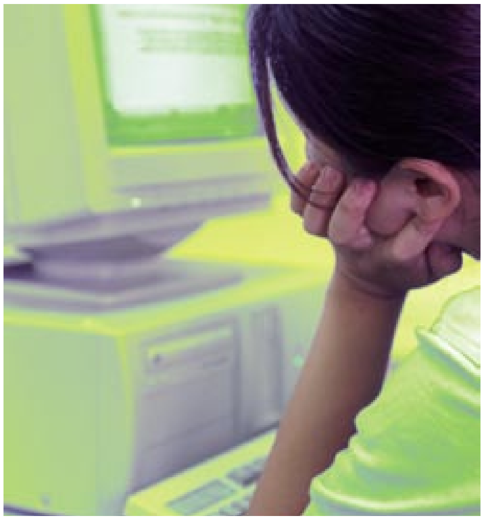
On November 6, 2007, FINRA issued Regulatory Notice 07-53, which provides guidance on the requirements of new Rule 2821 for deferred variable annuity (VA) transactions. The Notice sets out a May 5, 2008 effective date for the Rule and expresses FINRA's view that, among other things:

- The Rule does not require a registered representative to determine that the customer would benefit from all of the features of a VA or that the customer, in hindsight, actually took advantage of them.
- The VA application is "transmitted" to the insurer by its "captive" broker-dealers only when the broker-dealer's principal, acting as such, has approved the transaction, provided that the broker-dealer ensures that safeguards exist to prevent contract issuance prior to principal approval.
- A registered representative who "merely" delivers a prospectus to a customer ordinarily would not have a reasonable basis to believe that the customer has been informed about the material features of the VA.
- Principals are required to review all purchase and exchange orders for suitability, irrespective of whether the orders were recommended.
- The Rule does not permit the depositing of customer funds in insurance company accounts prior to completion of the principal review.

On December 21, 2007, FINRA filed a proposed Rule change with the SEC to delay the effective date of the Rule's principal review requirement until August 4, 2008. The purpose of the delay is to give firms additional time to make necessary systems changes and to give FINRA an opportunity to consider and possibly act upon concerns raised by firms, including concerns about the seven day review period, the applicability of the requirement to firms that do not make recommendations, and FINRA's interpretation that the Rule does not permit the depositing of customer funds in insurance company accounts prior to completion of the principal review.

Illinois Supreme Court Boots Class Action Against Intel

BY FARROKH JHABVALA



Computer frustrations not enough to keep class certified

The Illinois Supreme Court decertified a class action against Intel (*Barbara's Sales, Inc. v. Intel Corp.*) that had been certified by the Circuit Court in dreaded Madison County, Illinois. The complaint alleged that Intel had deceived consumers by using the name "Pentium 4" for its microprocessor because that name implied that it was the best and fastest processor on the market at the time. The plaintiffs, who were from Illinois and Missouri, alleged alternate counts under California and Illinois consumer fraud laws, and sought to represent a nationwide class. Plaintiffs contended that California law applied because Intel's principal place of business is in California, and the designing and marketing of the "Pentium 4" chip were primarily located there. Illinois law applied, they claimed, because most of the plaintiffs resided there and all plaintiffs received the alleged representation of performance implicit in the name "Pentium 4" in Illinois. The circuit court ruled that Illinois substantive law governed the claims and certified an Illinois-only class because it found that Illinois law could not be applied to consumers who lived or purchased their computers outside Illinois. The intermediate appellate court reversed the lower court's choice-of-law ruling, finding that California law (including section 17200) applied, and it ordered the lower court to reconsider its class certification order in light of California law.

The state supreme court granted Intel's interlocutory petition and found that the trial court had correctly concluded that Illinois substantive law applied. But the higher court concluded that the class certification was erroneous because the alleged implicit misrepresentation was not actionable under Illinois' Consumer Fraud Act. The allegedly uniform representation implicit in the name "Pentium 4" – that this processor was the best and fastest on the market – was nothing more than puffery, the supreme court concluded, and therefore was not a deceptive act within the purview of the Act.

Supreme Court to Review Exxon Valdez Punitive Damage Award

BY JULIANNA THOMAS MCCABE

The U.S. Supreme Court granted certiorari review of a $2.5 billion punitive damage award in *Baker v. Exxon Shipping Company*, a federal case brought by a class of private plaintiffs relating to the 1989 Exxon Valdez oil spill. The jury awarded approximately $20 million in compensatory damages and, based upon its conclusion that the ship's master acted recklessly, $5 billion in vicarious punitive damages against Exxon. The Ninth Circuit remitted the punitive damage award to $2.5 billion, but Exxon contended that even the reduced award exceeds the combined total of all punitive damage awards ever affirmed by the federal courts of appeals. The Supreme Court's order granting certiorari review is limited to narrow issues concerning punitive damages in admiralty cases, but the Exxon case will nevertheless be seen as part of the overall punitive damages landscape. The order limits review to three issues: (1) whether the Ninth Circuit erred in holding that vicarious punitive damage liability was available under federal maritime law because the ship's master was a managerial employee – a rule which conflicts with the decisions of four other federal circuit courts; (2) whether punitive damages are recoverable in a federal maritime case where Congress has enacted a statutory remedial scheme which affords civil and criminal, but not punitive, penalties; and (3) whether federal maritime law should limit punitive damage awards to a greater extent than constitutional due process as a matter of policy. The Court declined to consider Exxon's constitutional due process arguments regarding the *BMW v. Gore* guideposts, and the ratio of compensatory to punitive damages.

$2.5 Billion would be a whole lot of bullion

Class Representative Dooms Massive Class Action

BY ARI GERSTIN

Certification for a putative class of millions of ATM users was recently denied by the U.S. District Court for the Western District of Pennsylvania on the ground that the named plaintiff was not an adequate class representative. The complaint in *Martz v. PNC Bank, N.A.* sought actual and statutory damages under the Electronic Fund Transfers Act (EFTA) based on the alleged failure of some of the bank's ATMs to provide notice that a fee will be charged and collected as part of the transaction. Users of the offending ATMs were informed that a charge may be assessed.

After finding that the requirements of numerosity, commonality, and typicality were met, the court rejected certification based on the inadequacy of the named plaintiff, who had a close friendship with the class counsel. The record showed that the plaintiff and counsel were roommates in college and for several years thereafter, and that they remained close friends; that counsel approached the plaintiff about serving as the class representative; and that the plaintiff was also serving as the named plaintiff in another putative class action brought by the same law firm alleging similar EFTA claims. In addition, the plaintiff admitted that he was not certain that he was a member of the class he sought to represent because he did not fully read the ATM screen that constituted the alleged violation upon which the EFTA claim was based. The court explained that the close relationship between the putative class representative and class counsel created a conflict of interest for the named plaintiff and jeopardized the interests of the absent class members.

Not making the class

Third Time Not A Charm For Appeals of Class Certification Denials

BY MICHAEL SHUE

In *Asher v. Baxter International, Inc.*, the Seventh Circuit recently held that successive orders denying class certification did not give rise to multiple 10-day periods for seeking Rule 23(f) interlocutory appeals. In this securities fraud case, the district court below had denied three consecutive motions for class certification filed by Plaintiffs, ruling each time that the proposed class representatives were inadequate. After the court denied Plaintiffs' third motion, Plaintiffs attempted to pursue a Rule 23(f) interlocutory appeal for the first time. Although Rule 23(f) provides that a court of appeals may permit an appeal from a district court's class certification order if commenced within 10 days, the key issue in *Asher* was whether this 10-day period began after the district court's first order denying class certification, or whether each new order of the district court started a new 10-day period. Writing for the court, Judge Easterbrook explained that Plaintiffs' 23(f) interlocutory appeal window opened and closed within the 10 days following the district court's first class certification order, stating that "the time limit would not be worth anything if it restarted with each new motion." While acknowledging that its decision meant Plaintiffs could only appeal from a final decision, the court held that "the difficulties in pursuing a suit to a final decision do not justify taking liberties with Rule 23(f). The final-decision rule … is the norm, and Rule 23(f) is an exception that … must be used sparingly lest interlocutory review increase the time and expense required for litigation."

Mark Your Calendar

ALI-ABA Insurance Industry and Financial Services Litigation Conference will be held on April 3-4, 2008 in Phoenix, AZ. Jorden Burt Managing Partner **James Jorden** is the planning chair, and partners **Markham Leventhal** and **Wally Pflepsen** are on the faculty for the conference.

Arbitration Round-Up

BY LANDON CLAYMAN

Class arbitration waivers continue to come under fire. The U.S. Court of Appeals for the Ninth Circuit, following a decision of the California Supreme Court, declined in *Shroyer v. New Cingular Wireless Services, Inc.*, to enforce such a waiver contained in a consumer contract. The Ninth Circuit applied a three-part test designed by California state courts: (1) whether the agreement is a consumer contract of adhesion drafted by a party in a superior bargaining position; (2) whether the agreement occurs in a setting in which disputes between the parties predictably involve small amounts of damages; and (3) whether it is alleged that the party with the superior bargaining position has schemed to deliberately cheat large numbers of consumers out of individually small sums of money. The class arbitration waiver was found to be unconscionable under California law, and the dispute was not ordered to arbitration, but remained in the courts because a non-severability clause resulted in the entire arbitration agreement being voided.

The First Circuit in *Skirchak v. Dynamics Research Corp.*, a case brought under the Fair Labor Standards Act ("FLSA"), did not address whether all class action waivers violate the FLSA or public policy, but ruled that the waiver in question was unconscionable under Massachusetts law because of the manner in which it was presented to employees. The waiver was buried in a multi-paged attachment to an e-mail that was sent to all employees two days before the Thanksgiving holiday, and the e-mail did not inform the employees that the attachments changed the terms of their employment, restricted their access to the courts, and waived any right to bring class arbitrations.

In a case that pits the "party autonomy" interest of the Federal Arbitration Act against the Act's interest in providing a speedy, cost-effective, and efficient form of resolving disputes, the U.S. Supreme Court is poised in *Hall Street Associates, L.L.C. v. Mattel, Inc.*, to resolve a split among the federal Courts of Appeals by deciding whether arbitration agreements subject to the FAA may expand the grounds for judicial review beyond the limited grounds outlined in the Act.

Intellectual Property & Technology Update

What's in a Name, Trademark or Slogan?

BY DIANE DUHAIME

Everything - according to two trademark lawsuits filed in October 2007 by financial services companies. One of the lawsuits was filed by Minnesota-based Federated Mutual Insurance Company against Michigan-based Auto-Owners Insurance Company. Federated Mutual alleges that Auto-Owners' use of the slogan WE MAKE YOUR BUSINESS INSURANCE OUR BUSINESS infringes Federated Mutual's registered mark IT'S OUR BUSINESS TO PROTECT YOURS. Based on the U.S. service mark registration record, Federated Mutual has been using its mark for over 35 years. Federated Mutual alleges, inter alia, that Auto-Owners use of their mark for insurance services violates the Federal Trademark Act of 1946, commonly known as the "Lanham Act." The Lanham Act serves, first and foremost, to protect consumers from being misled by confusingly similar marks, and next to protect trademark owners against trademark infringement and unfair competition.

The other lawsuit was filed by Canada-based First Niagara Insurance Brokers, Inc. (First Niagara) against New York based First Niagara Financial Group, Inc. (the "Bank"). First Niagara alleges, inter alia, that the Bank is willfully infringing its FIRST NIAGARA marks and also brings claims under the Lanham Act. First Niagara's complaint provides the Bank changed its name from Lockport Savings Bank to First Niagara Financial Group, Inc. and adopted FIRST NIAGARA as a trade name and service mark in May 2000, approximately fifteen years after First Niagara first began using the FIRST NIAGARA trade name and marks. First Niagara asserts that after the Bank was unable to purchase the firstniagara.com domain name registration from First Niagara, the Bank purchased the nearly-identical domain name registration: first-niagara.com. The complaint cites to instances of actual consumer confusion, including First Niagara's receipt of thousands of e-mail messages (often containing personal and private information, such as social security numbers) from those who believed they were communicating with the Bank. Thus, this case presents privacy-related consumer protection issues as well.

NEWS & NOTES

Speeches

Joan Boros spoke at the Practicing Law Institute's conference "Understanding the Securities Products of Insurance Carriers," January 7-8, 2008 in New York.

Richard Ovelman lectured on "Communications Law" at a Practicing Law Institute Conference, November 8-9, 2007.

Jorden Burt co-sponsored a dinner for the 25th annual ALI-ABA conference "Life Insurance Company Products: Current Securities, Tax, ERISA and State Regulatory and Compliance Issues," November 8, 2007 honoring conference co-founder (and Jorden Burt Managing Partner) **James Jorden**. Partner **Richard Choi** was a co-chair of the program and partners **Gary Cohen** and **Shaunda Patterson-Strachan** were on the faculty.

Publications

Diane Duhaime authored "Why Should Corporate Counsel Become Familiar With Virtual Environments? Aren't They Just Fun And Games?" for the February 2008 issue of *Metropolitan Corporate Counsel.*

Ms. Duhaime also wrote "Victoria's Secret Case in 2003, Leads Nation to Trademark Dilution Revision Act of 2006," in the October 2007 issue of *Connecticut Lawyer.*

Mark your Calendars

Jorden Burt partners **Bruce Leshine** and **Diane Duhaime** will be co-sponsoring a Roundtable on Information Privacy and Security on February 28, 2008. Francisco Gari, Counsel for Global Technology Services at IBM will also be speaking. The 2-hour discussion at The Goodwin Hotel in Hartford is being submitted for CLE credits in New York.

JORDEN BURT LLP

JORDEN BURT LLP is the premiere national legal boutique providing litigation and counseling services to the financial services industry. The firm serves clients in six key industries:

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- Property & Casualty
- Reinsurance
- Mutual Funds & Investment Advisers
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- Banking & Consumer Finance

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